S. HRG. 99-1002

STATE TRADING ENTERPRISES

HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

S. 2660

AUGUST 6, 1986

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STATE TRADING ENTERPRISES

WEDNESDAY, AUGUST 6, 1986

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:36 a.m., in room SD-215, Dirksen Senate Office Building, Hon. John C. Danforth (chairman) presiding.

Present: Senators Danforth, Heinz, Grassley, Bentsen, and Baucus.

[The press release announcing the hearing, an opening statement from Senator Grassley, and a staff report follow:]

SENATE FINANCE COMMITTEE SETS SUBCOMMITTEE HEARING ON STATE TRADING

Senator Bob Packwood (R-Oregon) Chairman of the Senate Committee on Finance, announced today that the Committee's Subcommittee on International Trade will conduct a hearing on S. 2660 on August 6, 1986, at 9:30 a.m. The hearing will be held in SD-215 of the Dirksen Senate Office Building.

S. 2660, introduced on July 21, 1986, by Senators Bentsen, Danforth, Roth, Boren, Heinz, Symms and others, addresses the trade-distorting practices of state trading enterprises. Senator Packwood stated: "State trading has become a significant factor in international trade. Foreign governments increasingly attempt to exercise their unique power and authority to promote sales or purchases in international trade by their state-owned enterprises. The GATT recognizes that such trade-distorting activities are undesirable, but there has been virtually no enforcement of the GATT rules on this issue. Although our antidumping and countervailing duty laws afford some opportunity to counter certain unfair trade practices of state trading enterprises on a product-specific basis, S. 2660 would afford a remedy not only for dumping and subsidies but for the more subtle trade-distorting practices of state trading enterprises and do so on an enterprise-specific basis. Our hearing affords a timely opportunity to examine this issue and explore means of addressing this problem."

STATEMENT OF SENATOR CHARLES E. GRASSLEY

Mr. Chairman, I do not have a lengthy prepared statement this morning, however I do have a few brief remarks on this issue.

More and more the world trading system is being disrupted by the activities of state trading enterprises which buy and sell inconsistently with the commercial norms as stated in article XVII of the the GATT. Regrettably, these activities are on the rise * * * and it has now become an issue we must address if the United States is to maintain its key basic industries and promote a world trading system based on market forces.

In a world characterized by a free and open trading system, we can ill-afford to let governmental politics override sound commercial principles. Unfortunately, the State enterprises of today are composed of those which are dependent on continuing Government assistance to ensure their ongoing existence. Such governmental use of power and influence to intervene in the operation of market forces can only result in injury to the private producers.

Unfortunately Mr. Chairman, it has become clearly evident that once an enterprise is nationalized or established by the State, experience clearly shows that it will continue to be operated whether it is profitable or not for maintaining increased exports, employment or protecting home markets from import competition.

Mr. Chairman, we have an obligation to promote and defend the forces of a free market principle * * * to do less, I believe will result in an increase in unfair trade practices and a failure on our part to address the basic problem of private-State competition.

Mr. Chairman, I look forward to the testimony of our witnesses, and I will have several questions for members of the panel and the administration witness.

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United States Senate
COMMITTEE ON FINANCE
WASHINGTON, DC 20510

MEMORANDUM

TO: FINANCE COMMITTEE MEMBERS

FROM: FINANCE COMMITTEE TRADE STAFF
(Len Santos, 4-5472 and Jeff Lang 4-5315)

DATE: AUGUST 4, 1986

SUBJECT: HEARING ON S. 2660, THE "STATE TRADING" BILL

The Finance Committee's Subcommittee on International Trade will hold a hearing on S. 2660, the "Anti-Mercantilism Act," on Wednesday, August 6, 1986, at 9:30 a.m. in the Committee hearing room (SD-215). A witness list is attached.

I. Current Domestic and International Law

The General Agreement on Tariffs and Trade (GATT) does not forbid governments from trading through government agencies or state-owned or state-controlled firms.

However, Article XVII of the GATT, entitled "State Trading Enterprises," states that GATT members shall make purchases or sales involving either imports or exports "solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale." This GATT article also requires such enterprises to afford businesses in other GATT countries "adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales." These rules apply not only to state enterprises but to any enterprise granted "exclusive or special privileges" by a GATT-member government. Article XVII is enforceable in the same manner as other provisions of the GATT.

The United States has not implemented Article XVII in domestic law, but it has used Article XVII on rare occasions to argue against a foreign government's trade practices, such as arguing in 1982 that Canadian requirements for U.S. firms investing in Canada to buy their supplies from Canadian firms was contrary to Article XVII, and arguing in 1967 that British rebates given by the state-owned steel industry only to domestic companies that could demonstrate 100 percent domestic procurement violated the provision. In both cases, the practices were abolished.

II. S. 2660

This bill was introduced on July 21, 1986, sponsored by Senators Bentsen, Danforth, Roth, Boren, Heinz, Symms and three other Senators who are not Members of the Finance Committee.

Like GATT Article XVII, the bill does not attack all state trading, but only state trading that is not conducted in accordance with the "commercial considerations" rule of Article XVII (which the bill labels "mercantilist"). Specifically, the bill --

a. makes mercantilist trade that burdens U.S. trade or commerce actionable under section 301 of the Trade Act of 1974 (the President's existing authority to retaliate against foreign unfair trade practices) on the ground it is a violation of the GATT;

b. provides the President discretion to impose quotas on imports by or from state trading firms, in cases where the U.S. International Trade Commission (ITC) finds, after an on-the-record public hearing, that such a firm has acted contrary to the "commercial considerations" rule and that imports from that firm injured an efficiently and economically operated industry in the United States (the quotas would be set at the level of imports that would occur if the GATT rule were obeyed); and

c. requires the President, in the proposed new round of multilateral trade negotiations, to seek agreements from GATT countries which utilize state trading to a significant degree that they will abide by Article XVII, and to get similar agreements from countries that are applying for GATT membership (Particularly in the case of the People's Republic of China).

III. Background

State trading is now a preferred means of conducting international trade in many countries of the world. Such enterprises take a variety of forms. They include wholly-owned corporations, such as British Steel or the French nationalized companies. State trading is also increasingly conducted by state companies in petrochemicals, minerals, fertilizers, and refined oil products. It is estimated by the American Embassy in

Mexico City that 850 enterprises in Mexico are owned by the Federal Government of Mexico. The largest employer in Europe was identified in recent European news reports as IRI, an Italian state-holding company. Those enterprises controlled by governments or granted "exclusive or special privileges" (to use the GATT phrase) by governments are probably even more pervasive.

In many cases, such enterprises have the appearance of private business corporations, but in fact are operated with political and social considerations as the primary determinant of business decisions. In France, the French state-owned tobacco company, SEITA, runs at a loss, reportedly because the government has not wanted to raise the price of the politically sensitive Gauloise cigarette, which remains much cheaper than imported cigarettes. Information supplied by the U.S. Trade Representative (USTR) and a recent ITC report on trade in commuter and business aircraft show that in Brazil a state-owned business aircraft company benefits from a complex web of duties, nontariffs barriers, subsidies, licenses, embargoes, and other practices. In Germany, USTR information shows that the state-owned telecommunications monopoly resists buying imports through what are, in effect, requirements that telecommunications products purchased by the monopoly be manufactured in West Germany, even though West German manufacturers are free to export such equipment to the United States. Therefore, it is possible to say that public enterprise, often responsive to different pressures than those affecting purely private U.S. firms, is associated with limitations on U.S. exports and injury to U.S. domestic industries.

Although the precise volume of state trading is hard to estimate, most experts believe that state trading accounts for an increasing share of world trade. State negotiation of buyback and barter arrangements alone were estimated to represent thirty percent of all international trade in 1982 by Business Week. Several developments in international markets are behind this growth of state trading.

In developing countries the state often takes the lead in sponsoring and organizing economic growth and trade. Since commodities are commonly the primary exports of these developing countries, much of the commodity trade is at least formally in the hands of the state.

Beginning with the mid-seventies, newly-available funds became subject to state guidance in these developing countries. For OPEC and the New Industrialized Countries (NICs), these funds came through trade; for countries like Brazil and Mexico, the funds were borrowed. In both sets of cases, their expanded role in international trade has meant an expansion in the role of state trading, and a reduction of direct, market transactions between private buyers and sellers. Ironically, the collapse of international commodity prices in the last few years has accelerated this trend. This collapse has resulted in a shortage of hard currency with which to purchase imports. This, in turn, encourages these state traders to engage in barter and countertrade arrangements in an effort to increase the export value of these commodities and bypass the hard currency shortages. The private enterprises of developed countries have, in the interest of making export sales, entered into barter and countertrade arrangements with state traders.

Trade with centrally-planned economies in Eastern Europe and elsewhere has substantially expanded since 1970, adding to the impact of state trading on international trade. Particularly in Western Europe, trade with the East now accounts for a significant portion of all trade.

Although not a new phenomenon, a major portion of the arms trade is conducted by national governments and the figures suggest that this trade has been expanding at about the same rate as the foreign trade of industrial countries in general.

In many ways, the arms trade is the model for the new mercantilism. Armaments is the sector where it is most difficult to distinguish between economics and politics, between the state and the private sector. Governments are clients -- they buy the arms. But they are also investment bankers, financing not only production, but research, design, and development. They are also merchant bankers, finding foreign buyers, organizing the sale, financing the sale, organizing the offsets, dumping the bartered counterparts, and financing services, such as training and maintenance that make the sale -- and follow-on sales -- possible. The market is characterized by discrete, giant contracts rather than by marginally adjusting commodity flows.

The mixed aid packages, offsets, and barter that characterize those contracts make true prices difficult to compute, and the complex financing and cost structures and practices of the manufacturers of large-scale, sophisticated armaments, make real costs equally obscure. The contracts are most often negotiated government to government, with coplex political considerations replacing simple price-quality calculations. In many ways the arms trade is the model of the new mercantilism, as well as its most important quantitative expression. It is also one of its most important creators, developing the habits, the channels, and the institutions that then spin off into other sectors.

Attached are two case studies on state trading compiled by Professors John Zysman and Stephen Cohen of the University of California, Berkeley.

(TED-0467)

ATTACHMENT

Petrochemicals in Brazil.[82] They sound like sad shepherds out of Homer's Odyssey: Polyvinyl, Polyurethane, Polyethylene. But most everything we wear, touch (and often eat) these days reduces down to a hydrocarbon chain, to these basic building blocks of the new alchemy of petrochemistry. Brazil's appetite for petrochemicals was enormous. Ethylene output grew by over 40% between 1970-77. The state-owned energy company, Petrobras, contracted for giant, state-of-the-art petrochemical plants to be built in Brazil by American multinationals. A small percentage of locally produced goods went into the first plant, and almost no local engineering. A second plant increased the content of local engineering, but it was still essentially a turnkey operation. A black box was delivered, on schedule, with complete instructions for its operation. For the next series of plants, the Brazilians tried a new, aggressive and risky approach, and they seemed to have won.

The purpose of the new multi-plant contract was not simply the creation of a certain volume of ethylene capacity at a certain price (though that was not neglected), but rather the creation of competitive advantage through the creation of a state-of-the-art and self-developing Brazilian engineering capability in process petrochemical engineering. The state enterprise, Petrobras, requested bids from four international petrochemical engineering firms. The American engineering firms Lummus and Stone & Webster, did not wish to create their own competition; their bids did not provide for the kind of technology transfer the Brazilian state sought. Nor did that of the German firm, Linde. Only the French firm, Technip, took the contract, in all its terms. It may be worth studying why they chose to do so.

Technip is a relatively young engineering company. It was started in 1958 by the French government, interestingly enough, to do in refineries exactly what the Brazilians were trying to do in ethylene plant technology. At that time international petroleum firms, and American process engineering, completely dominated the then rapidly growing French market for refineries and continuous process petrochemical technology. Technip was created to acquire the know-how so that a French firm could play a major role in building refineries and process plants first in France and then abroad. It succeeded mightily. With the substantial help of the French government as a gatekeeper and a tough contract negotiator, it was able to appropriate the requisite know-how through a series of contracts, rather like those of the Brazilian case: The existence of sufficient technical diffusion permitted the French government to use its enormous power over entry into the French market and to find a weaker firm, but one possessing sufficient know-how, and force it, as the price of entry, to convey that know-how to Technip. Technip could then begin to operate as a national champion, and was given a string of major contracts, by government controlled oil companies. It quickly became the number one plant engineer in France, and developed enough experience, expertise, and a long enough track record to begin to venture abroad.

Technip is owned by a consortium of French state-owned petroleum companies, state-owned banks, and later on materials and machinery makers (PUK), also now state owned. It was created to act not as a simple firm, but as an instrument of national economic development policy; it has, over the years, continued to act that way. Profit maximization is not its overwhelming goal. It makes profits, but it does not seek to maximize them. In industries such as engineering, where the task consists of designing large and costly plants or roads, as in architecture and city planning, the profits of the consulting engineers or planners are a very small piece of a much larger pie. The big bucks are in the provision of the hardware: the machinery, materials, and building supplies. The engineering or architectural firm is often a spearhead for one or a group of such suppliers. Thus, there is nothing particularly unusual about Technip's behavior. But it is an extreme case. It spearheads the industrial core of an entire nation. As Technip's executive vice president candidly put it:

> The structure of our capital makes us an instrument for a certain kind of policy. Take Elf, for example, with 25% of our capital. I don't think that Elf bases its financial strategy on what we do. It demands that we shall not lose money, but I don't think that it expects us to make extremely high profits . . . we must continue to work to develop the company as a technical tool which promotes the technology of France.[83]

The Brazil deal represented therefore many things for Technip and its parents, the industrial core of France: First, it was an attractive business opportunity all by itself, a chance for a second string company to break into a big, new market, and diversify its operations (at the time overwhelmingly centered back home in France and in Eastern Europe). Because it was not a dominant company, it had relatively little to lose by giving away the state-of-the-art know-how. So there were perfectly sound, normal business reasons for Technip, unlike Lummus, Stone & Webster, and Linde, to jump after the Brazil contract. But beyond that, it was an important foot in the door for French suppliers—and not just suppliers of materials and machines and software for the ethylene plants. The strong French presence in the ethylene operation, working directly and intimately with Petrobras, the strongest industrial force in Brazil, the training of corps of Brazilian engineers in the intimate knowledge of French machines and technology, of French ways of doing things, French computer programming, and even the French language, was seen as an important and valuable entry into large-scale, cooperative endeavors in a widening circle of industries in Brazil. Technip is a lead office—not a major profit center—for a big company, in this case the entire French economy. In all these ways it had advantages—and strategic considerations—that were quite different from its competing American and German firms.

Competition in Civil Aircraft Revisited: The International Dimension. The European Airbus, described earlier, brings together almost all these new trade wrinkles in one product, in a market where the stakes are sufficiently high to make it more than just another example. The estimated market for the new generation of wide-bodied aircraft, as things now stand, overwhelmingly to be divided between Airbus and Boeing, is variously estimated as between $100 and $150 billion dollars, with the U.S. market accounting for only about 40% of the total.[84]

Airbus, as we examined earlier, was created as a consortium among European governments; the aeronautical firms involved are both private and public, though mostly public. Government direct investment funds put it in business under conditions where "private risk capital" would most likely not, and kept it in operating during a long, slow, costly, and unpromising start (from 1971 to 1977 Airbus sold only 57 planes)[85]—a disastrously costly start. Using an indirect and crude method, the Boeing Company, not a disinterested observer, estimated that Airbus has received over its ten-year existence upward of $5 billion (1982) dollars) in manufacturing subsidies.[86] The Airbus investment was just the type of thing the market would be most unlikely to sustain; under "normal" market conditions the program would have been halted years ago. It is therefore the kind of thing the developmental state should do. No official estimates of the manufacturing subsidies—or, as seen from the European end, the very long-term, high-risk investment—are available. But Airbus was clearly a very expensive effort to buy into an industry. The effort is beginning to pay off. Starting in the very late 1970s, and continuing up through the present, Airbus sales picked up smartly. By 1980 they had about one-third of world sales in wide bodies; last year they reached over 50% of new orders.[87] Through the introduction of a new A310 model this coming spring (and a proposed A320), Airbus will soon offer an entire "family" of aircraft—a necessity if one intends to be a permanent presence in the industry and challenge the Americans for world leadership. For the Europeans, especially the French, Airbus is proving to be a success in its most important dimensions. It is the most visible and successful example of European economic cooperation (even if 25% of it is U.S. made). As such, it is politically precious, and must be preserved at almost any cost. It has opened up a European prestige presence throughout the world, and it created a strong European industry in what is seen as a key advanced industry. Without Airbus, the European aircraft industry would likely have disappeared. The European governments may even recoup parts of the $5 billion that Boeing saw as a manufacturing subsidy, and they saw somewhat differently. But the payback may still be many, many years out. They must still front the costs of the A320 program, which seems likely to cost well over one billion dollars to launch.

Airbus has also benefitted, it is alleged, from other new mercantilist wrinkles. The French state at the very highest levels seems to be out selling Airbusses, using the powerful, complex leverage that only a well-organized development state can mobilize to encourage sales. The French press regularly reports visits by top government officials, ministers, even prime ministers and presidents to foreign government officials where the sales of Airbusses were discussed, usually in the context of a broad package of economic, political, and cultural relations between the two countries. Sometimes this system is worked in reverse, because overwhelmingly, outside the U.S., buyers of new commercial aircraft are governments, or government-owned and operated airlines, which seem never to lose sight of their role within the entire set-up of their governments' political and economic strategies. The complexity, and prevalence, of this game became apparent when the Australian government announced that as a condition for their purchase of Airbusses, the French government would have to use its considerable influence within the common market to increase access for Australian sheep. The French government official (of ministerial rank) immediately engaged France to make such an effort. This is an extreme—and double-edged—example of the complex barter nature of so much of world trade. A state that can organize itself into some kind of a super trading company commands certain advantages under these new rules and procedures.[88]

There is, of course, another side to the Airbus-Boeing competition over the rules of trade, and U.S. firms, especially in aircraft production, are not simply passive, injured parties. As we noted earlier, Airbus argues that the U.S. commercial aircraft industry has steadily benefitted from substantial Pentagon subsidies: The Pentagon underwrote development costs of the GE jet engine that powers so many wide bodies all over the world (including Airbus); Pentagon orders for military aircraft that are only slight variations on civil aircraft keep the lines running and thereby subsidize the commercial market as in the case of the K-135 military jet tanker, which is a relatively minor adaptation of the Boeing 707.[89]

Airbus's American competition has, over the past few years, as it watched one foreign sale after another slip into European hands, been crying "foul" as loudly as they can about yet another form of non-market selling practice: below market, or subsidized, financing and risk insurance. On a big-ticket item like a $50 million airplane, a few points difference on financing can be a decisive advantage. (Boeing estimates that a 2% interest advantage on the sales terms outweighs a 5% advantage on fuel economy—the big difference between the new generation of wide bodies and the older generation.)[90] Below "market" financing rates for Airbus is commonly acknowledged in the world business press.[91] Even the French business press acknowledges substantial government financing as well as subsidies in each Airbus sale.[92] When, after extremely strenuous efforts, Airbus finally broke into the U.S. market with a big sale to Eastern Airlines (its only U.S. sale thus far), Frank Borman, the former astronaut and Chairman of Eastern Airlines, told the employees of that ailing carrier in a much-cited outburst of enthusiastic candor: "If you don't kiss the French flag everytime you see it, at least salute it. The export financing on our Airbus deal subsidized this airline by more than $100 million."[93]

Until a one-year agreement on aircraft financing—"common line"—was reached in September 1981 (and extended for a few more months in September 1982), Airbus financing was available for as little as 7½% and constituted a major commercial advantage.[94]

Governments have for years supplemented purely private techniques of export finance in order to assist their companies' sales efforts abroad. Selling abroad raised specific problems, which if resolved could increase the total volume of trade. Operating on a pay-as-you-go basis, government programs often served to make the financing of foreign trade more effective and were not simply instruments of competition among nations. However, in the past twenty years or so such programs have begun to serve as competitive instruments in the international competition for capital goods sales. As national instruments of competition, export financing techniques often embody substantial government subsidies, either to all qualifying exports or to those projects favored by governments. If one nation's subsidies are met by its competitors, then a round of international price cutting ensues. The only advantage from subsidized export comes if the programs in one nation allow greater price cuts than its competitors or make a more clever use of such subsidies. Price cutting through finance, as noted before, makes it difficult to determine exact prices and makes it harder for competitors to respond.

In the early 1970s efforts began to negotiate limits on the competitive use of such techniques.[95] Those efforts culminated in the 1978 "Arrangement on Guidelines for Officially Supported Export Credits." This Arrangement, like the Consensus reached a few years earlier, excluded military equipment, agricultural commodities, nuclear power plants, many categories of ships, and aircraft. The arrangement in aircraft, known variously as the Gentlemen's Agreement or the Commonline Agreement, has been unstable precisely because the partners to it have sharply different interests. In the financing of aircraft, as in other sectors, a number of technical matters complicate negotiations on the proper use of finance in competition. Those technical matters reflect enduring differences in the national organization of domestic financial markets as well as more temporary conditions such as domestic interest rates and specific balance of payments conditions. However, at the core the negotiations founder, when they do, on a simple matter. Some governments wish to participate more aggressively in international trade promotion than others. Joan Pearce summarized the matter well: "Those that have subsidized most have been trying either to increase their market share (France and Japan) or prevent it from declining (Britain), while those that have subsidized least have been comparatively satisfied with their market share (Germany and until recently the United States)."[96]

Senator **Danforth**. This is a hearing on a much talked about but little remedied problem—the question of State trading. Senator Bentsen and I and others have introduced S. 2660, the Antimercantilism Act, which is designed to try to get at this problem. Article 17 of the General Agreement on Tariffs and Trade requires that State trading enterprises operate in accordance with commercial considerations. However, it is widely recognized that article 17 has been not as effective as one would like.

So, this is a hearing on S. 2660 and on the broader question of State trading. Senator Bentsen.

Senator **Bentsen**. Mr. Chairman, first, let me thank you for holding this hearing. State trading, as you have referred to it, in itself is not an unfair trading practice; but we find certain actions in connection with State trading can be quite unfair, and GATT provides for that. And we have, as you say, article 17 that deals with it.

We have occasionally used that in arguments in trading disagreements with other countries. We did that in Canada, as I recall, when they were requiring that American companies invest in and buy Canadian products; but neither the Congress nor the executive branch has really come to grips with this problem. We assume because Government in this country owns and controls so little of trade that that is what we are up against with other countries. It is obviously not the case.

Free trade means that State trading companies ought to be competing as though they were commercial companies working for a profit and not just to achieve some political objective for that country. I don't think we can any longer ignore State trading. We can look at a country like Mexico, where the government owns so much of industry, and to the credit of President Della Madrid, is trying to divest itself of at least part of that.

We look at our dealings with Europe, and we see there countries where we think of the private sector being so strong, such as Germany, yet a substantial amount of State-owned trade. We see that in France and we see that in England, in spite of their policy of divestiture in that regard. So, we ought to recognize that and we have to meet that.

I think, as we get into this, Mr. Chairman, it is going to become difficult to find a practical, feasible way to apply commercial considerations to article 17; and obviously, we have to discuss that internationally, but we must also be prepared to use the GATT rule, section 301, and our own domestic laws to try to level that playing field with the private sector and State trading.

So, this bill that we have introduced is a starting place. I hope we will find means of improving on it, fixing it, making the changes, and then get this bill enacted into law.

The problems presented by State trading companies are not something that we can just continue to sweep under the rug. They are continuing to grow and making it more difficult for the private sector in this country. Thank you, Mr. Chairman.

Senator **Danforth**. Senator Baucus.

Senator **Baucus**. Thank you, Mr. Chairman. I join in the comments of the Senator from Texas. I think the bill is an essential first step in addressing this problem.

I have seen estimates that only about 25 percent of the goods and services traded in this country are under a private commercial laissez faire free enterprise system; the rest is government-controlled state trading—the socialist countries, East European bloc, whatever. And obviously, as a country becomes more intertwined with the decisions of other countries, this is a problem that we must address.

I think the bill is a good step in that direction.

Second, I think this is something that must be included in the new GATT round. We have had a couple of hearings already on matters that should be included in a new GATT round; state trading definitely must be one. And I hope that as we and other countries do meet in a new round, that we resolve this problem very, very effectively. Thank you.

Senator DANFORTH. We are pleased that our first witness is Alan Holmer, general counsel of the USTR. Alan, you are becoming an expert witness in the Finance Committee. Thank you very much for being back.

STATEMENT OF HON. ALAN F. HOLMER, GENERAL COUNSEL, U.S. TRADE REPRESENTATIVE, WASHINGTON, DC

Mr. HOLMER. Thank you, Mr. Chairman. S. 2660 is an effort to address a problem that the administration acknowledges is a real one: trade distortion caused by State enterprises, acting not necessarily as profit-seeking commercial entities, but as instruments of Government policy.

State enterprises are common in world trade today. Developed country State trading organizations are prominent in agricultural trade; for example, the Canadian Wheat Board or the National Food Agency in Japan. Government ownership of producer firms is common in certain industries such as telecommunications. And monopolies are common in such industries as railways and declining industries that have been nationalized. State trading and State-owned industries are most common in the developing world, where a high share of GNP may pass through the Government even in market economies.

The administration has and is acting on a number of fronts to address the problems of State trading. For example, we are working actively to open markets and fight trade barriers in telecommunications, aircraft, and many other areas, using section 301 and other statutes. We will address State trading as we work out the terms of China's reaccession to the GATT, and we look forward to working with you in developing our negotiating objectives as they relate to China. The countervailing duty law already provides that Government equity infusions or loans on terms inconsistent with commercial considerations are subsidies. The Commerce Department has found high subsidy levels in many instances—just ask the British Steel Corp. or the Brazilians. And we have called for an overhaul of the nonmarket economy dumping laws, including provision of a predictable pricing test along the lines of that introduced by Senator Heinz.

We support—and I appreciate the comments made by Senator Baucus—a review and overhaul of the provisions of article 17 of the GATT to take place in the new round of multilateral trade negotiations. We expect that the review will establish a common frame of reference for applying article 17—more sensitivity, we would hope, to practices inconsistent with the provisions of article 17, and more exact rules on what article 17 really means. I should note that State trading operations, whether in market economies or nonmarket economies, were not the careful, deliberate focus of the GATT drafters' attention as were other trade issues—for example most-favored-nations treatment, or national treatment, or tariff bindings, or import quotas, or some of the other restrictions that are included in the GATT.

Article 17 expresses the GATT drafters' concern that the value of trade concessions not be impaired, without providing a detailed roadmap to what the solutions should be to State trading problems. It enshrines the principle of nondiscriminatory treatment, but in relatively soft and ambiguous language, rather than a crisp, clearcut statement of rights and obligations.

The United States has taken a strong and bullish view with respect to article 17 in the GATT. Our views have not universally been shared by our trading partners, and therefore we look forward to correcting that issue in the new round. We welcome the introduction of this bill and the dialog that it will, we believe, create between this subcommittee and the administration in terms of how we can go about addressing this issue. In my written testimony, I describe some of the concerns that the administration has with respect to S. 2660 as presently written.

I would be happy to address those in response to questions as well as providing, Mr. Chairman, suggestions as to how the bill could be modified to make it more palatable to the administration. Thank you, Mr. Chairman.

Senator DANFORTH. Thank you, Mr. Holmer. Senator Bentsen.

[The prepared written statement of Mr. Holmer follows:]

Testimony on S. 2660

Alan F. Holmer, General Counsel
Office of the U.S. Trade Representative

before the Subcommittee on International Trade
United States Senate Committee on Finance

August 6, 1986

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to testify before you today on S. 2660, the Anti-Mercantilism Trade Act of 1986.

S. 2660, introduced just sixteen days ago, is an effort to deal with a problem that we acknowledge is a real one -- trade distortion caused by state enterprises acting not necessarily as profit-seeking commercial entities but as instruments of government policy. In 1947, the drafters of the GATT recognized that state enterprises could undercut the benefits of any trade concessions achieved through negotiations. To meet this concern, GATT Article XVII provides discipline on purchases and sales by state enterprises. S. 2660 is intended to implement Article XVII in U.S. law.

State enterprises are prominent in world trade today. Developed country state trading organizations are prominent in agricultural and commodities trade (for instance, the Canadian Wheat Board or the National Food Agency in Japan). Government ownership of producer firms is common in certain industries, such as telecommunications, natural monopolies such as railways, and declining industries that have been nationalized. State trading and state-owned industries are most common in the developing world, where a high share of GNP may pass through the government even in market economies.

At the outset, I would like to point out to you examples of the ways in which this Administration addresses the trade problems related to state enterprises. First, unfair foreign government trade actions of any kind are actionable under section 301. If a foreign government puts up barriers to its market, it does not matter for section 301 purposes whether it does so directly or whether it directs a state enterprise to do so. Second, as the numerous countervailing duty cases on steel products have made clear, government equity infusions into any firm in a market economy are a countervailable subsidy where they are inconsistent with commercial considerations. The Commerce Department has fairly valued those subsidies, resulting in substantial countervailing duties.

This Administration is very much aware of the potential for trade distortion if the provisions of Article XVII are not observed. For that reasons, we have supported a review and renewal of the provisions of Article XVII, to take place during the New Round. We expect that the review process will establish a common frame of reference for applying Article XVII, more sensitivity to practices inconsistent with the provisions of Article XVII, and more exact rules on what Article XVII means. This renewed awareness on the part of our trading partners will help us in our bilateral and multilateral efforts to eliminate unfair trade practices.

Government trading entities, or trading entities that are government-owned or -controlled, can introduce serious distortions in the international marketplace. That is the reason why the drafters of the GATT provided discipline on such entities in GATT Article XVII. S. 2660 addresses this problem, but in a manner that would likely lead to violation of our international obligations. Also, the bill aggregates two problems that are qualitatively different-- state trading enterprises in market economies, and non-market economy trade. Provisions aimed at one problem would have unforeseen and undesirable effects on the other. For these reasons, we cannot support adoption of S. 2660 as drafted. In particular, we oppose inclusion of any provisions on non-market economy trade in this bill. On the other hand, the bill does address certain problems of international trade for which existing U.S. and international law may be inadequate. We are willing to review whether such inadequacies exist and, if so, how they might be rectified.

State Trading and International Obligations

I would like to turn now to the international agreement background of S. 2660. The sponsors of S. 2660 have pointed to the dangers of state trading, and have urged the adoption of S. 2660 as a means of implementing in U.S. law the provisions of Article XVII of the GATT.

The provisions of GATT Article XVII on state trading enterprises apply to two quite different problems. The focus of Article XVII at the beginning of the GATT system was on preventing state enterprises in market economy countries from undermining the value of trade concessions. The second, more recent problem is state trading by non-market economies. The concern here is how to intergrate centrally planned economies into the GATT system. Because the drafters of Article XVII didn't really focus on the latter problem, legislation on this subject should not mechanically take its cue from Article XVII.

Article XVII recognizes that state trading enterprises can be operated so as to create serious obstacles to trade. Accordingly, it calls for trade negotiations to limit or reduce such obstacles, imposes certain obligations on the conduct of state trading enterprises, and provides for notification and information about their activities.

Two other GATT provisions are worth attention in this context. Under Article II:4, a state import monopoly may not operate so as to afford protection on the average in excess of a bound tariff. And in general, the GATT provisions on import and export quotas explicitly include quotas implemented through state trading enterprises. If one of our trading partners establishes a public corporation that has the sole right to import widgets but that corporation refuses to import widgets at all, it violates of the prohibition on import quotas in GATT Article XI.

Under Article XVII, each contracting party undertakes that if it establishes or maintains a state enterprise, or grants to any enterprise, formally or in effect, exclusive or special privileges, such an enterprise shall, in its purchases or sales involving either imports or exports, act in a manner consistent with the general principles of non-discriminatory treatment prescribed in the GATT for governmental measures affecting imports or exports by private traders. For instance, a government cannot use a state enterprise to take actions that would violate the national or most-favored-nation treatment obligations in GATT Articles III and I.

Article XVII further explicates this standard of conduct to require that state enterprises, having due regard to the other provisions of the GATT, must make any purchases or sales solely in accordance with commercial considerations, including price, quality, marketability, transportation and other conditions of purchase or sale. This obligation extends only to purchases and sales of goods, and explicitly does not preclude a state enterprise from charging different prices in different markets, provided that such prices are charged for commercial reasons, to meet conditions of supply and demand in export markets.

Further, state enterprises must afford the enterprises of the other GATT contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in their purchases or sales. The drafting history indicates that "customary business practice" was intended to cover business practices customary in the respective line of trade.

Similar provisions on state trading enterprises appear in the friendship, commerce and navigation (FCN) treaties negotiated by the United States: for instance, article XVII of the U.S.-Japan FCN Treaty.

Finally, contracting parties to the GATT must notify the GATT of what products are state-traded. On request, they must notify the import markup on a product that is subject to an import monopoly, if the item is not subject to a tariff binding. In practice, these notifications are updated yearly. In the past the United States has notified its state trading in fissionable materials, helium, the national strategic stockpile, and dairy and miscellaneous agricultural products. The GATT can also request a party with a state trading enterprise to provide information about its operations relevant to its GATT obligations.

S. 2660 and What It Would Do

Under S. 2660, action would be taken on three fronts regarding state trading enterprises in market economies, and regarding non-market economy trade as well. The scope of such action would be broader than Article XVII, and could violate U.S. obligations under the GATT. In some cases, these additional remedies would duplicate existing law, or are otherwise unnecessary and inappropriate.

(1) Amendments to Section 301 of the Trade Act of 1974:

Section 5 of S. 2660 amends section 301 to make these three situations "unjustifiable" practices actionable under section 301:

(1) when a foreign government requires a state trading enterprise to make purchases or sales, or compete with U.S. firms, on a basis that is "not dependent on" commercial considerations;

(2) when a foreign country assists a state trading enterprise (even in ways that would not legally constitute a subsidy) in making purchases or sales in international trade, or competing with U.S. firms, on any basis that is not dependent on commercial considerations; or

(3) when a foreign country fails to give U.S. firms adequate opportunity, in accordance with customary business practice, to sell to, or buy from, state trading enterprises.

Section 5 would determine whether state trading enterprises' purchases and sales were based on commercial considerations by reference to similar arm's-length transactions; this standard is not in Article XVII at present, although we are sympathetic to negotiation of such a standard for applying Article XVII. If the evidence of arm's-length commercial sales were insufficient, section 5 would look to the constructed value of the merchandise, as computed under the U.S. antidumping law.

These amendments to section 301 are unnecessary and inappropriate. In the case of state trading enterprises in market economies, all three of these scenarios are already actionable under section 301. Violation of Article XVII is already actionable as a violation of a trade agreement, or as an "unjustifiable" practice. We have taken Article XVII violations to the GATT already; for instance, we invoked Article XVII in attacking Spain's soybean oil state trading monopoly and the Japanese tobacco monopoly. And even conduct that does not violate Article XVII outright is actionable if it is "unreasonable" under section 301. Thus, section 5 may be repetitious of existing law under section 301. We are particularly concerned by proposals to broaden the definition of "unjustifiable," since other amendments to section 301 that are currently before the Congress include some which would require mandatory self-initiation or mandatory retaliation in the case of "unjustifiable" practices.

We also object to the provision in section 5 tying the measurement of "commercial considerations" to the constructed value of the merchandise purchased or sold. It is wholly inappropriate to graft this antidumping concept into section 301. It would make potentially actionable, for instance, the purchase of any traded input, or the sale of any good or service, by a market-economy state enterprise at any price less than fully-allocated cost plus 8 percent profit. This goes considerably beyond Article XVII. In fact, Article XVII explicitly permits the charging by a state enterprise of different prices for its sales of a product in different markets, provided that such sales are charged for commercial reasons, to meet conditions of supply and demand in export markets.

Because section 4 of the bill broadly defines "state trading enterprise," section 5 would also sweep into its scope the actions of state trading enterprises in non-market economies. But because NMEs present different problems, they require a different approach. Our economic relations with them differ, and within an NME the relationship between a state enterprise and its government is differs. A standard of conduct that calls for an arm's-length relationship between a state enterprise and its government may be appropriate for market-economy economy situations, but not for the fundamentally different situation in non-market economies. For instance, section 5 could be read as requiring NME sellers to price worldwide at fully-allocated cost plus 8 percent profit (a figure that we consider meaningless under current NME antidumping rules). Setting standards for the appropriate interface between the market and non-market economies is a complex task meriting special consideration, not as an ancillary issue in this bill.

(2) Import Relief Against State Trading:

Section 6 of S. 2660 proposes a new import remedy modeled on section 337 of the Tariff Act of 1930. Sales by a state trading enterprise conducted on any basis that is not dependent on commercial considerations would be actionable if: (1) a foreign country has exercised its authority, influence or power for the purpose of promoting or consummating such sales, and (2) such sales have the effect or tendency to substantially injure an efficiently and economically operated industry in the United States, to prevent establishment of such an industry, or to monopolize trade or commerce in the United States. The ITC would measure whether state trading enterprises' purchases and sales were based on commercial considerations by looking to similar arm's-length transactions, or by looking to constructed value of the merchandise, as computed under the U.S. antidumping law.

The ITC would conduct an investigation, with a one-year deadline. If it determines positively with regard to each factor above, the Commission would have to determine how much the state trading enterprise in question would have sold into the U.S. if its sales had been based on commercial considerations. The Commission could then either exclude all imports above that level from that enterprise, or order the state trading enterprise to cease and desist from conducting sales on bases inconsistent with commercial considerations. The President would have 60 days to review any such order, and could veto it for policy reasons.

Mr. Chairman, this proposed remedy raises serious questions concerning our international obligations. Under the GATT, we are required to provide national treatment for products of GATT members. Except for those trade remedies explicitly recognized by the GATT, such as antidumping, countervailing duties, escape clause relief or customs enforcement against counterfeiting, our laws must provide treatment to imports that is no less favorable than the treatment given to like domestic goods. Under our FCN treaties, we have similar obligations with regard to enterprises -- including state enterprises -- of our treaty partners.

The remedy proposed here does not meet these tests. Although sales of both domestic and foreign products would be equally actionable, the exclusion order remedy would be targeted solely at imports. This is a violation of GATT Articles III and XI. Third, the remedy itself is targeted solely at conduct by foreign owned or controlled state enterprises. This may violate our national treatment obligations under bilateral treaties. The President's ability to disapprove exclusion orders for policy reasons (which could include GATT or treaty violations) does not cure these problems.

There are other aspects of this hybrid remedy that need further thought. For instance, as drafted, the scope of the ITC's investigatory powers includes sales of services and products, yet the exclusion order remedy only reaches products. The tie to constructed value is also troubling. We object to any proposal that would make it possible to end-run the antidumping laws and get, in effect, antidumping relief without the procedural protections and the material injury test that are required by the GATT and the Antidumping Code. From a practical standpoint, the tie to constructed value would require the ITC to make antidumping determinations, a task for which it is not equipped, and could lead to conflicting and confusing interpretations of the antidumping law on constructed value.

Finally, as stated above, we oppose inclusion of NME state trading enterprises in the scope of this remedy. We also oppose mandatory auctioning of import licenses. Auctioning of this type is an untested idea, and flexibility in implementing it would be a must.

(3) Negotiating Authority:

Section 7 of S. 2660 amends the current non-tariff barrier negotiating authority in section 102 of the Trade Act of 1974 to impose additional requirements on section 102 agreements made with countries where state trading enterprises account for a significant share of exports or import-competing goods. Any section 102 agreement with such a country would have to include an agreement that its state trading enterprises will make purchases (except for procurement for government use) and sales on the basis of commercial considerations (including price, quality, availability, marketability, and transportation), and that it will afford U.S. firms adequate opportunity, in accordance with customary practice, to compete for participation in such purchases or sales.

These requirements would apply to all future section 102 agreements (including those negotiated in the upcoming round of trade negotiations). They would also apply to extension of the GATT or the Tokyo Round Codes to such countries. The United States would be required to withhold application of the benefits of any multilateral trade agreement until the country concerned enters an agreement with the United States (or an agreement to which the U.S. is a party), or the Congress approves fast-track legislation providing otherwise.

Mr. Chairman, we are still studying section 7. Its potential implications are substantial. It would affect our bilateral relations with many countries. China obviously heads the list, in view of its expressed interest in re-joining the GATT, but the scope of section 7 would also include many developing countries, such as Mexico, Egypt and Israel. The philosophy behind section 7 is one with which we are sympathetic. Encouraging greater development of the private sector in developing countries is a goal the Administration values highly. However, we need to think carefully about how to balance these proposed preconditions for any section 102 agreement, with our overall and sectoral negotiating goals for the New Round and the priorities we arrive at in consultation with Congress and the private sector. It will not serve American interests if these goals, elevated to the status of a sine qua non, prevent or significantly impede achievement of other goals that may be more important.

Thank you for the opportunity to share these views today. I will be happy to answer any questions.

Senator BENTSEN. Can you give me a cut of the percentage of imports that come from State-owned companies abroad? What percentage of our imports?

Mr. HOLMER. I don't have that off the top of my head, Senator Bentsen. We would be happy to provide that for you for the record. I would suspect that number would be reasonably high.

Senator BENTSEN. I would think so, but we ought to have something to buttress this and deal more in fact that just our guesses on it. Would you get that for me, please?

Mr. HOLMER. I would be happy to, Senator.

[The prepared information follows:]

Senator BENTSEN. And how many cases in the past—in GATT cases—have we advanced the argument of article 17, alleging that they weren't acting as a commercial enterprise would—a for-profit enterprise? And what has been the result in those cases?

Mr. HOLMER. There have been three cases, Senator Bentsen. The first was the one that you had mentioned, where we filed a complaint against Canada's Foreign Investment Review Agency. We presented arguments there under both article 17 and article 3 of the GATT. Frankly, the argument that we made with respect to article 17 was unsuccessful, although the argument that we made with respect to article 3 was successful before the GATT panel.

The second case was a 1981 GATT case involving Spain and its imposition of consumption quotas on soybean oil. The panel report was unfavorable to our position. I believe the principal issue in that case was whether the Spanish instrumentality would be considered a State trading enterprise.

And the third case related to the Japanese restrictions with respect to cigars and pipe tobacco, which we also challenged under article 17. In these cases, Japan agreed to liberalize its market and to reduce the import duties. Therefore, we terminated our investigation in January 1981. As you also know, we are revisiting the issue of tobacco trade with the Japanese right now in our self-initiated 301 case. That has a deadline of the middle of September. ber.

Senator BENTSEN. Yes; insofar as what you requested then. I unginning and then their agreement to liberalize it, did they follow through?

Mr. HOLMER. The Japanese?

Senator BENTSEN. Yes, insofar as what you requested then. I understand you are reopening it on tobacco.

Mr. HOLMER. In terms of the practices that we had complained of, the Japanese have corrected those practices; but our import share has remained at or below 2 percent. We consider that to be grossly unsatisfactory, which is why the President, 11 months ago, directed USTR to self-initiate a 301 case.

Senator BENTSEN. So, we had a distinction without a difference?

Mr. HOLMER. I would not disagree with that characterization, Senator.

Senator BENTSEN. Which is not unusual with our dealings with that country. You are opposed to any import remedy, as I understand it, for State trading; and one of the reasons is, as I understand it, the difficulty in estimating what percentage of our market that that country would have obtained, had they followed through commercial objectives and practices. And if that is the case, how did the United States figure out that the United States semiconductor chips, that comes to 20 percent of the market in Japan—how did we calculate the level of our retaliation in the recent citrus case against the European Community, where they refused to limit it by the GATT rules, and we limited their imports?

How did we decide that is the problem? How much wheat flour to sell in Egypt in retaliation against the French?

Mr. HOLMER. I recognize that those are difficult calculations for the International Trade Commission or for the USTR or for the President to make.

Senator BENTSEN. That is not a reason to back away, just because it is difficult.

Mr. HOLMER. Exactly, and we are not unwilling to make those determinations. And while I believe that the determination that is being asked of the ITC in S. 2660 would be a difficult one—and frankly, as you might suspect, the administration would probably have more confidence if you gave that authority to the executive branch, as opposed to the ITC—that I don't believe would be a reason to oppose S. 2660. These are hard judgment calls to make, but we shouldn't be afraid to make them.

Senator BENTSEN. Thank you. I have run out of time.

Senator DANFORTH. No problem.

Senator BENTSEN. All right. We also posed the import remedy because it is not authorized under the GATT and would violate the GATT international rules—national treatment rules. Would it be more acceptable if we passed a law for all governmentally owned companies, including U.S. companies, that they obey the commercial considerations rule? If we put that into law?

Mr. HOLMER. I think that would make the statute substantially more acceptable under the GATT. The whole national treatment issue and how you would craft S. 2660 in a way that is consistent with article 3 of the GATT is a very difficult one; but we would want very much, Senator Bentsen, to work with you and with your staff in terms of trying to provide you with whatever guidance we can as to how it would be crafted to make it most defensible in GATT terms.

Senator BENTSEN. Thank you, Mr. Chairman.

Senator DANFORTH. Senator Baucus.

Senator BAUCUS. Mr. Holmer, is it the USTR's view that article 17 is presently insufficient?

Mr. HOLMER. Yes.

Senator BAUCUS. What considerations does the USTR have or does it suggest in order to change article 17? What should be actionable and what not?

Mr. HOLMER. What we hope to be able to accomplish in the new round would be a number of things, but in particular, we would hope that it would define clearly what constitutes State trading and also come to a general agreement as to what the article requires of contracting parties that State trade. As you know, we are in a relatively embryonic stage as to precisely what it is that we are going to achieve with respect to State trading in the new round of trade negotiations. There has not even been a launching of that new round; and frankly, we would look forward to working closely with all of you in terms of deciding exactly what it is that we would like to achieve. But, it would seem to me that the kind of standard in terms of how we all have interpreted article 17, that is to say, that State trading enterprises should act in a manner that is consistent with commercial considerations, both in their sales and purchases of imported and exported products, would be an appropriate standard that the world could live by with respect to State trading enterprises.

Senator Baucus. Does the USTR or the administration have some sort of a timetable in order to address and determine this position on what constitutes State trading and what the remedies should be in order to change article 17 in a new round? Do you have a timetable in order to deal with that?

Mr. Holmer. This is one of the critical items that we expect that the Finance Committee is going to want to address during the course of the discussion of the omnibus legislation, and we would expect to be working with the staff of the Finance Committee on a relatively urgent basis between now and the end of the month in terms of, one, what the objectives are for the new round and, two, with respect to how legislation might be crafted to make it most acceptable to the administration.

Senator Baucus. Has the USTR ever considered utilizing section 301 to stop an unfair trading practice—a State trading practice as an unfair trading practice?

Mr. Holmer. Yes, it has. For example, the earlier Japan cigar and pipe tobacco cases.

Senator Baucus. Why isn't section 301 sufficient? Why do you need a change in article 17?

Mr. Holmer. We don't believe that we need a change in article 17 to be able to address that practice in Japan. If we are not able to achieve a satisfactory liberalization of the Japanese market, and particularly in terms of increased U.S. exports—not just the kind of liberalization that might have occurred in 1981 that didn't result in increased imports—

Senator Baucus. I am speaking more generically, not specifically with respect to Japan; but why generally isn't section 301 sufficient to address the issue of some unfair State trading practices?

Mr. Holmer. The principal problem is, in a perfect world, you would want to be able to have a situation where, if the United States is taking action unilaterally—which is what section 301 is all about—that there be some internationally agreed standard against which we are acting. We are generally able to do that under section 301, although there are some exceptions to that overall rule. But normally, we would far prefer, if we are going to be acting unilaterally, that we had some international consensus that forms the basis for that unilateral action. Otherwise, we run the risk that, if we do act unilaterally, for example, to restrain exports to the United States, that a foreign country could take us to the GATT, arguing that we have acted illegally and attempt to achieve GATT sanction for retaliation against other U.S. exports.

That is not to say we are unwilling to act under section 301 under appropriate circumstances. But in addition to that option, we would like to have the international cover to justify the U.S. action.

Senator BAUCUS. Maybe you have addressed this: What is the USTR reaction to the provision of auctioning quotas under S. 2660? Is that a good idea?

Mr. HOLMER. The reaction is the same here as with respect to other proposals to auction quotas. The administration does have concerns because of the substantial practical problems that may be presented. We believe there is a lot more study that needs to be done before we ought to go down that path.

Senator BAUCUS. What about the cease and desist orders under the bill, once one has found injury?

Mr. HOLMER. The cease and desist order, as I recall, states that the U.S. ITC would tell a foreign state trading enterprise that it is to cease its unfair trade practice. The principal concern, I think, that I would have with that is whether or not it would be a workable standard and whether or not the foreign State trading enterprise would listen to what the ITC had to say.

Senator BAUCUS. I appreciate your concerns. You are a good lawyer, but we have got to find some solutions here, too.

Mr. HOLMER. Absolutely, and we want to work with you in doing that.

Senator BAUCUS. So, I would urge you to spend more time looking for solutions, frankly, while you are looking at some of the practical problems. Thank you.

Mr. HOLMER. Thank you, Senator.

Senator DANFORTH. How big a problem is this, Alan?

Mr. HOLMER. I think it is a relatively substantial problem, particularly with respect to the developing world, which is going to have to be a major part of the effort to get our trade deficit down. If we are not able to increase our exports to developing countries because of State trading practices that those countries may engage in, my guess is that we will never be able to dig ourselves out of the trade deficit hole.

Senator DANFORTH. Can you quantify it, that is, in percentage of world trade?

Mr. HOLMER. I have not been able to. There has not been a great amount of literature on the subject. As I indicated to Senator Bentsen, we would be happy to try to quantify what amount of trade that presently comes to the United States relates to or comes from State trading enterprises.

Senator DANFORTH. Is it so varied and so pervasive that it is difficult to get a handle on it? Is it the kind of thing "you know it when you see it," but it comes up in so many varied forms that it is difficult to get a handle on it?

Mr. HOLMER. Yes.

Senator DANFORTH. Does that mean that it is useless to try to get a handle on it, or that it is difficult?

Mr. HOLMER. I think that the bill that you and Senator Bentsen and others have introduced really focuses on what is an important issue now and may become an even more important issue in the future, and that we really need to grapple with.

Senator DANFORTH. Is 301 an appropriate tool to deal with it?

Mr. HOLMER. It certainly is.

Senator DANFORTH. Can it be used now to deal with it?

Mr. **Holmer**. Yes, and has been used to deal with it under certain circumstances. I reference the Japan cigar and pipe tobacco cases.

Senator **Danforth**. Should that be broadened? Should 301 be broadened somehow or made more readily available? Or do we already have all the tools we need today?

Mr. **Holmer**. I think that the administration could support some kind of clarification that the activities of State trading enterprises, in general along the lines as described in your bill, are actionable under section 301. But what we need to do is to make sure that we don't go so far afield from article 17 of the GATT that we take actions that are clearly GATT-inconsistent.

For example, one standard included in the bill states that one way to determine whether practices are inconsistent with commercial considerations is to use the fully loaded constructed value methodology used by Commerce in determining what an appropriate sales price might be. That seems to us to go beyond what the drafters of article 17 had in mind. But it seems to me that it is possible to address that problem without undercutting the thrust of S. 2660.

Senator **Danforth**. Let me ask you one, I think, related question although it might be doubtful in the minds of others.

You have put a lot of stake in the new round in addressing this problem in that new round. Do you think that the ability to enter into a new round or the ability to successfully complete a new round of trade negotiations would be affected by overriding the President's veto on the textile bill?

Mr. **Holmer**. I think it would be killed by an override of the President's veto.

Senator **Danforth**. Why?

Mr. **Holmer**. Our trading partners, who are in many respects still skithish about proceeding with a new round of trade negotiations, would see that as being such a sign by the Government of the United States that it is perfectly willing to disregard the GATT rules in a blatant and flagrant way, that they would not regard seriously any statement by the executive branch of the United States that it wished to work toward a more liberalized world trading order.

Senator **Danforth**. Furthermore, why conduct any negotiations with the executive branch of our country if, a week after the negotiations are completed, Congress repudiates the negotiations?

In other words, the MFA was entered into last week, wasn't it?

Mr. **Holmer**. Yes, sir.

Senator **Danforth**. And bilaterals were entered into last week with Taiwan and Hong Kong and 2 days ago with Korea?

Mr. **Holmer**. Yes, sir.

Senator **Danforth**. And wouldn't they be repudiated by an override of the veto?

Mr. **Holmer**. Without question.

Senator **Danforth**. So, Congress would have just said, in effect, to the world: You can negotiate with the executive branch all you want, but as far as we are concerned, the negotiations are for naught?

Mr. **Holmer**. That is absolutely correct.

Senator **Danforth**. Senator Heinz.

Senator **Heinz**. Mr. Chairman, just briefly, there have been some people who have suggested that my nonmarket economy bill be expanded to include the kind of problems that Senator Bentsen, in this bill, addresses. I am a cosponsor of Senator Bentsen's bill on the State trading companies. And I have resisted efforts to expand the scope of my bill for a number of reasons, not the least of which is that to try to expand it beyond nonmarket economies to take into account the actions of nonnonmarket, Western, if you will, activities of State-owned trading companies, would go well beyond the original intent of my bill.

And I also have a lot of interest in what this legislation does in and of itself. My question to you is this: Looking only at the nonmarket economy side of the equation, let's assume for the moment that we enact a nonmarket economies bill that strengthens our ability to deal with nonmarket economy dumping or subsidies, if you will. At that point, how much of the activities of nonmarket State trading companies would fail to be addressed by my bill, and to what extent would we still need this kind of legislation to address the issue of State trading companies in nonmarket economies?

I think Senator Bentsen and others have made a very good case for the necessity of taking action under 301 with respect to the kind of practices that the French engaged in with Airbus where I gather there was an under-the-table promise to go and do certain other unrelated things in order to obtain a sale to Australia. They promised some kind of quid pro quo which wasn't actionable under countervailing duty laws or under antidumping laws, but it was an unfair trade practice.

Do we need to be sure that when we deal with this issue that it include both nonmarket economies and their State trading companies, as well as market economies?

Mr. **Holmer**. I am reasonably confident, Senator, that, if a dumping remedy for nonmarket economies along the lines of what you have proposed is enacted—and I realize we continue to have some discussions about the benchmark and the injury test—but something along those lines, I believe, would substantially address all of the significant trading problems that we have with nonmarket economies where there is an injury to a U.S. industry. If there is some problem that is not addressed, I think we would have flexibility in all likelihood under section 301 to be able to address it.

Senator **Heinz**. Would you oppose making this legislation applicable both to market and nonmarket economies? And I don't have an ax to grind here. I mean, I want the best possible tool, and I want this legislation to do the best possible job.

Mr. **Holmer**. Right. We do have some concerns about that. Our reading of S. 2660 is that it lumps nonmarket economies together with market economies, and we believe that nonmarket economies obviously are fundamentally different from market economies. And some of the standards of conduct that are in S. 2660—for example, an arms-length relationship between a State enterprise and its government—may very well be appropriate for a market economy situation, but really aren't applicable or don't work for the fundamentally different situation in a nonmarket economy situation. You really don't have——

Senator HEINZ. Maybe we are talking technicalities and are really splitting technical hairs. Is that possible?

Mr. HOLMER. I don't think so. I think it really is a very fundamental issue as to whether or not S. 2660 would apply both to nonmarket economies and to market economies. I just don't know how you establish an arms-length relationship between a State trading enterprise in a nonmarket economy with its government. I just don't know how you can do that.

Senator HEINZ. Thank you very much. My time has expired.

Senator DANFORTH. Mr. Holmer, thank you very much.

Mr. HOLMER. Thank you, Mr. Chairman.

Senator DANFORTH. Next, we have a panel: Willis Bussard, executive director, U.S. Association of Countertrading Corporations; John Paul, on behalf of the American Mining Congress; Dale Hathaway, former Under Secretary of Agriculture for International Affairs; Kenneth Millian, on behalf of the Ad Hoc Committee of Domestic Nitrogen Producers; and Charles Verrill, on behalf of the Ad Hoc Committee for Domestic Nitrogen Producers and Chaparral Steel Co.

Mr. Bussard, I understand that you are on the run; you have another meeting in about 20 minutes. So, why don't you proceed; and then, if members of the committee have questions for you, we can put them to you and then we will proceed with the rest of the panel.

STATEMENT OF WILLIS A. BUSSARD, EXECUTIVE DIRECTOR, U.S. ASSOCIATION OF COUNTERTRADING CORPORATIONS, PRINCETON, NJ

Mr. BUSSARD. Thank you, Mr. Chairman. I appreciate your consideration. I have been requested to present to this committee some of my observations regarding the present status of countertrade in international commerce and how pervasiveness of this trade phenomena might affect your own deliberations on the Senate bill 2660.

My qualifications for presuming to offer some comments to this committee stem from over 18 years of operating and investigating responsibilities in international trade and particularly in countertrade. In 1968 and 1974, just for background, I was first introduced to what was called East-West trade at that time as both director of purchasing for the United Fruit Co. and president of its trading company.

During those years, I was also involved in organizing the first effort to form a cooperative of U.S. corporations which could work together to solve some of the problems that countertrade or East-West trade created in their marketing in East Europe. In more recent years, I have been involved in significant studies of the growth of countertrade, both with LDC's and with developing countries, which unfortunately now numbers over 100 separate countries.

At present, I am again trying to help organize a cooperative effort of major U.S. corporations, particularly exporter manufacturers as the executive director of this new Association of Countertrading Corporations.

Our goal, as was true years ago, is to develop a countertrading support system together that will allow competitive marketing of U.S. goods and services overseas into an environment that is certainly laced with countertrade requirements. It was with these credentials that perhaps I can offer some comments that will prove helpful in your own deliberations on how to do business with State trading companies. I have submitted separately to the committee a packet of materials which represents some of my past viewpoints and comments as well as others, which you can use for your evaluation.

I have also prepared a short summary statement which I think you have now, available for your evaluation. And to conserve your time for questioning, I would just like to briefly summarize why I feel a clear understanding of what exists in countertrade today will be helpful in arriving at the solution that I think we all want to find.

Without going through all of these points, there are several that I have tried to summarize very succinctly here. One is that countertrading is now an accepted way of conducting business with over half the trading nations of the world, and information is in the material to back that up. This need for countertrading stems primarily from the inability of over 80 countries to offer hard currency to sellers in exchange for their goods and services, whether those are U.S. goods and services, French, Austrian, or whatever you will.

Every country faces the same problem of trying to do business with many, many countries without the chance of getting hard currency in exchange. So, almost all exporters, both United States and otherwise, I think today acknowledge that their ability to deal with this situation is a commercial requirement that enables them to compete in the international marketplace. I would like to take time to say that one of the points I would like to make is this: This is a multilateral problem dealing with all nations caution would be that, if we try to solve a multilateral problem with a unilateral solution, it is not going to help reduce our trade deficits.

Thank you, Mr. Chairman.

Senator **Danforth**. Thank you, sir. Any questions for Mr. Bussard? Senator Baucus.

Senator **Baucus**. Mr. Chairman, thank you. Mr. Bussard, are you saying that, although there are reasons for countertrade, that is, lack of hard currency and some other reasons, that State trading is an issue that is separate and distinct from the need for countertrade? That is, are you saying that State trading, whether or not it is countertrading, is a problem in the world that should be addressed multilaterally, or are you saying that countertrade, because of the need for countertrade in some instances, is special and therefore should not be regarded as much as State trading in the case where the State trading is in hard currency?

Mr. **Bussard**. As I think has been brought up before, and it was brought up by the first witness, nonmarket and market economies do differ in the way they are constructed; and as we have observed already, both types, market and nonmarket, do have State trading organizations as defined in your bill.

Unfortunately, in countertrading, it is a complex subject, and it involves many aspects and facets of international trade. Obviously, it is to the benefit of both a market or a nonmarket economy to be able to have some focus for that. As I have tried to summarize in my other points, we in U.S. industry have in a sense developed that same kind of focus. The major corporations who have had to face this problem, years ago—like General Motors trading, Caterpillar, and most recently, General Electric trading company (major corporations) have also focused that effort and set up their own "trading company." This is a counterpart, if you will, to a State trading corporation handling the same problem, either in a market or a nonmarket economy.

Senator BAUCUS. So, as I understand it, you are saying that if State trading should be actionable where it deals in hard currency, that same State trading should be actionable even though it is countertrade? I am trying to understand the degree to which you think that countertrade should be treated separately from other kinds of State trading. Is State trading in countertrade different from other kinds of State trading?

Mr. BUSSARD. As I read the bill, it seems the implication is that a State trading company is one that buys or sells for other than its own use. Is that the simplest definition of a State trading company?

Senator BAUCUS. I would think that some State trading is reprehensible and an unfair trading practice, and some others are probably not. It depends on whether the commercial considerations are available. That is why I raised the question the way I did.

Mr. BUSSARD. If you are talking about either buying or selling, certainly every time we sell, or in this case, buy oil from Pemex in Mexico, we are dealing with a straight State trading organization, a very strong one. And if there is an attempt to control their activity in the United States, that is one thing. The other thing is, if we try to talk with AgroExport or one of the foreign trade organizations of Poland, we are dealing with another kind of entity.

Senator BAUCUS. Let me ask the same question a little bit differently. Do you think that countertrading State trading should be treated any differently than noncountertrading State trading?

Mr. BUSSARD. I would caution whatever action or solution is developed that it does not imperil the ability of U.S. companies to export overseas.

Senator BAUCUS. Thank you.

Mr. BUSSARD. That is my main point.

Senator DANFORTH. Mr. Bussard, thank you very much for your testimony.

Mr. BUSSARD. Thank you.

Senator BENTSEN. Let me ask just one question, if I might. Mr. Bussard, do you think that we can solve this problem in our lifetime, when you talk about not doing it unilaterally, that it has to be done multilaterally? I don't quite see the discrimination—the distinction—between the bartering and the sale for hard currency, if I understand what you are driving at. I have had some difficultly, frankly, interpreting what you are saying.

Mr. BUSSARD. We have a problem in definition which, I think, always comes up when we talk about countertrade. I tend to use the term "countertrade" as an overall umbrella generic term, which includes many of the problems that Congress and other committees are facing; and that is of equity investment overseas instead of in the States, subcontracting overseas instead of in the States. Many of these options stem from the same reason that these LDC's and other developed countries don't have the ability to offer us, or any other seller, hard cash is because they are not able to be equal on the international marketplace. They need help to develop that ability so that they will be able to sell, and then we can go in and get hard currency.

Until that time, though, some people have defined the opportunity that lies in countertrade—if you can find one—is that it allows private companies to help developing countries achieve economic independence by helping them raise up their market—their products—so that they meet market requirements. Then the cash can start to flow.

Senator **Bentsen**. Thank you very much.

Senator **Danforth**. Thank you, Mr. Bussard. Mr. Paul.

[The prepared written statement of Mr. Bussard follows:]

Statement of Willis A. Bussard, Executive Director of the U.S. Association of Countertrading Corporations, to the Senate Finance Subcommittee on International Trade on August 6, 1986.

Mr. Chairman:

I have been requested to present to this committee some of my observations regarding the present status of "countertrade" in international commerce, and how the pervasiveness of this trade phenomenon might affect your own deliberations on Senate Bill S 2660.

My past comments and studied conclusions on the impact countertrade plays in the competitiveness of U.S. exporters have been submitted separately. However, any program to alter ground rules for conducting international commerce should carefully consider the following factors:

- Countertrade is now an accepted way of conducting business with over half the trading nations of the world.
- This need for conducting international commerce through countertrade stems primarily from the inability of over 80 countries to offer hard currency to sellers in exchange for their goods and services.
- The reasons for this shortage of hard currency are many and often beyond the control of the many nations involved, especially the LDCs.
- As a result, a growing number of countries now must seek out potential trading partners who are willing to sell their products or services for some consideration other than hard currency.
- Almost all exporters, U.S. and otherwise, acknowledge that their ability to deal with countertrade is now a commercial consideration that enables them to compete in today's international marketplace.
- The desire to trade for other than cash considerations also stems from more than a lack of hard currency. Our own government's Commodity Credit Corporation activities are not compelled by a shortage of dollars; nor was the recent activation of the Peace Shield program in Saudi Arabia compelled by a lack of cash.
- In using countertrade effectively for national purposes, a government may find it helpful to employ the services of a state-trading agency, or to establish a state-trading group for this specific purpose.
- This same strategy is increasingly being used by major U.S. companies in order to compete successfully in a countertrading environment. Corporate trading companies, such as Motors Trading, G.E. Trading Company, Caterpillar World Trade, C-E Trading Company are just a few examples of these private counterparts to state-trading companies.

To summarize the close relationships that shape selling strategies in today's international market, three conclusions bear repeating:

1. In selling U.S. exports to over 100 countries, a willingness to accept countertrade instead of cash in international sales is an accepted commercial consideration as well as a competitive requisite.
2. Countertrade and its attendant need for a trading company, be it private or state, will continue to be a requirement for success in international trade for many years.
3. Any attempt to control or restrain the growth of countertrade must be achieved through multi-lateral agreements, not unilateral legislation. To do otherwise will sharply limit the competitiveness of U.S. exports in the world marketplace.

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Policy Analysis

U.S. INDUSTRY AND GOVERNMENT MUST DEVELOP A MORE EFFECTIVE RESPONSE TO COUNTERTRADE

by Willis A. Bussard

Over half of the trading nations of the world rely on countertrade as a way of initiating or maintaining the flow of goods across their borders. Even in the United States, the government has arranged for the exchange of surplus agricultural products for strategic materials. Every year, the U.S. government agrees to "offsets" amounting to billions of dollars in the sale of weapons systems to other developed countries. Over 25 bills addressing the various forms of countertrade were introduced before the last Congress. Countertrade and offset arrangements for the obligatory exchange of goods or services are reshaping the pattern of international trade.

Latin America is deeply involved in countertrade out of necessity, not choice. As debt repayment problems have persisted, importation of foreign goods has declined drastically. Countries simply lack the cash to purchase goods abroad. In many countries, where multinationals experience blocked funds, innovative new trade financing schemes (the essence of countertrade) seem the only way to release funds.

The Basic Causes of Countertrade

The root cause of countertrade is the growing disparity between the national resources and productive abilities of different areas of the world. Trade imbalances, immense international debts, and depleted reserve funds throughout the world occur when the free exchange of goods and services is severely hampered by lack of natural resources, noncompetitive production facilities, undeveloped marketing skills, and inadequate economic structures. All may be intensified by endemic political and social instabilities inherited from history.

Countertrade can be entirely eliminated only by identifying and abolishing the deeply imbedded causes of economic inequality between nations. Until that happens, the obligatory exchange of goods is the only recourse many countries have to cope within a world of unequals. It may also offer the only way for them to obtain the technology they so desperately yearn for and need. In some cases, both parties benefit from countertrade. The question remains, however: Does this represent the kind of trading we want to encourage in the future?

Many nations in Latin America resort to countertrade because they lack the financial strength and economic leverage to obtain desired results under a free trading system. Colombia is just one example. In February 1984 Decree 370 was passed to limit the use of foreign exchange reserves to essential imports only until agreement on Colombia's foreign debt repayment schedule is reached. Importation of luxury goods was eliminated and the development of incremental goods or resources was encouraged. As a result of the decree, many firms exporting cameras, computers and other restricted items to Colombia were forced to develop new or additional Colombian exports. Only through the sale of these incremental exports could the companies obtain cash for their sales to Colombia.

An example of how countertrade often benefits foreign competitors of U.S. firms can be seen in a deal struck between Colombia and Bulgaria to develop a privately held coal reserve. An initial swap of $5 million worth of Bulgarian mining equipment for $5 million of Colombian coal was arranged. If this first exchange proves successful, there is the promise of an additional $45 million worth of coal shipments. Each partner in this countertrade arrangement obtained its desired result in a complex bilateral agreement.

Needed: New Alternatives

To obtain new customers in a tight export market and retain old customers overseas, many U.S. exporters are scrambling to develop innovative ways to compete in restricted markets. While the high value of the dollar can be initially overcome by more attractive products, dealing competitively with countertrade demands may be the next hurdle facing the U.S. exporter. To secure an order he may be asked to put up equity investment, agree to co-production or joint ventures with his anticipated customer or purchase components (perhaps at a better price) in the importing country.

Today's buyer increasingly expects the seller to be willing to help develop exports. Many countries, including France, Germany, Sweden, Italy, and Austria have established national countertrade support systems which offer various kinds of assistance to their exporters.

Only a few large multinationals in the United States – General Motors, General Electric and Sears, for example – have been able to develop their own support systems through subsidiaries or a countertrade department. For most medium-sized and small exporters this is a luxury beyond reach.

A survey by The Countertrade Project, a program designed to develop basic data, strategy and programs to help U.S. exporters deal with the increasing demands for countertrade, reveals that many U.S. companies are losing export sales to foreign competitors receiving government support. Little assistance is available from the U.S. government. Indeed, countertrade is in direct conflict with the U.S. policy of supporting multilateral trade through active membership in the GATT and the OECD. Thus, each company depends on its own resources for handling compensatory obligations.

It can be different. A number of options are available. However, they all depend on industry's willingness to unite to solve a mutual problem. An organization like France's ACECO (Association pour la Compensation des Echanges Commerciaux) or SODICOMEX, a newly established French countertrade exchange, could offer American companies the same counselling and support that ACECO provides for over 200 French exporters competing overseas.

Another option is a countertrade cooperative, like that initiated by United Brands in the early days of East-West trade. Already some major U.S. companies are cooperating on an informal basis to help one another discharge their obligatory compensations.

Before any final solution is selected, both industry and government need to carefully identify the real issues at stake in countertrade. Long range consequences must be measured against short range benefits. The irreversible impact of transferred technologies, for both buyers and sellers, must be closely evaluated. There is a strong need for industry and government to develop a workable policy to assure the competitiveness of U.S. companies in a world of growing countertrade.

The International Trade Commission is currently conducting a survey of over 600 U.S. companies dealing with countertrade. The results and conclusions of the survey will be completed in August. In October, President Reagan is expected to submit a report on countertrade based on the conclusions of an inter-agency study of the practice. The findings of these government reports may represent the beginnings of a foundation for an official U.S. policy toward countertrade.

But industry should not depend on government alone to build an effective policy response to the issue of countertrade. The ability of private industry to unite in its own interests is crucial if U.S. exporters are to regain competitiveness in a world of complex, alternative trading arrangements. Even when the value of the dollar falls to more reasonable levels and U.S. goods are again price competitive, we as a nation must develop a satisfactory response to the question: "What will you accept in exchange besides cash?"

To remain competitive, we need a better answer than any available to us today.□

Willis A. Bussard is Director of the Countertrade Project.

* * News Release * * * .News Release * * * News Release * * 6

US ASSOCIATION OF COUNTERTRADING CORPORATIONS
WILLIS A. BUSSARD, EXECUTIVE DIRECTOR

For release on January 15, 1986

NEW STUDY REVEALS U.S. NEEDS IN COUNTERTRADE

The future success of U.S. exports will increasingly depend on a willingness to accept countertrade obligations in international sales. This is a commitment competitors in other countries have already made to enhance their own balances of trade. It is a decison major U.S. exporters agree they must make to halt the deteriorating balance of U.S. trade.

These same companies also agree that duplicating the effective countertrade support systems that already exist in other industrialized countries will require mutual cooperation among all U.S. corporations, plus judicious and restrained assistance from Washington.

These are the main findings of a study: "The National Issues, Concerns and Needs for U.S. Countertrade" recently completed by the U.S. Association of Countertrading Corporations and released today.

This study of the attitudes of over 100 major exporters toward countertrade was initiated by the USACC to supplement the current findings on the same topic by two government agencies: the International Trade Commission and the Office of Management and Budget. The purpose of the USACC study was to more clearly define the growing demands placed on U.S. exporters by the countertrade environment, and to understand how U.S. industry can best meet these demands which are contributing to the sluggish growth of U.S. exports.

As confirmed by the study, "countertrade" is not seen as a specific but as a generic term. It includes any international sale in which any seller, in addition to providing safe delivery of his goods and services, must agree to engage in some additional activity which economically enhances the status of the buying country. It may vary from strict barter to financial investment in the buyer's country.

Growing demands for some form of countertrade are of increasing concern to over 85% of the major corporations represented in the new USACC study. They report receiving demands currently for countertrade from over 65 specific countries. Very few U.S. exporters enjoy selling products so unique or necessary to hard-pressed countries that these countries are willing to release their limited foreign reserve funds without requesting some offsetting obligation.

These demands for countertrade are increasingly requested from all sellers, not just from U.S. exporters. Therefore U.S. corporations recognize that any unwillingness to accept them can only result in lost sales, reduced market oportunities and reduced profits.

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Of prime concern to U.S. exporting companies are three new developments: the need to develop completely new marketing strategies; the loss of control in these transactions to third parties; and, in some cases, the prospect of increased contingent liabilities when non-performance penalties are applied by the seller.

Most U.S. corporations share with the U.S. government a strong concern for this growing restraint on free, multilateral trading, and the effect it is having on our trade deficit. Yet, at the same time, exporters are apprehensive about receiving too much assistance from Washington. Overreactant and unilateral legislation by Washington alone may prove to be a constraint rather than a benefit to U.S. exporters. It can prevent rather than strengthen their ability to compete with sellers in other countries not so constrained by their own governments.

At the same time, however, 50% of U.S. corporations report many positive benefits from their willingness to accept countertrade contracts. These include: increasing export sales, locating new and lower cost materials and parts, and developing new long-term supply sources for critical materials. Other advantages include the freeing of blocked funds and, in some cases, unexpected opportunities for maintaining employment of their own work forces in the U.S. Full acceptance of countertrade from hard-pressed countries can provide a competitive edge in the world marketplace, as well as satisfy a corporate conscience. As one company replied:" It offers us a chance to provide aid to a deserving LDC while at the same time creating a win-win situation for both of us."

But not all U.S. corporations find positive benefits in countertrade, especially those to whom it has meant lost sales. As the recent ITC Study* found, at least $1 billion in foreign sales has been lost through countertrade by U.S. companies over the last five years. The new USACC study confirms this liability as 50% of the companies report losing sales to countertrade. However, in most cases, it was attributed either to their unwillingness to accept the principle of countertrade or to their inability to find acceptable countertrade goods.

Many U.S. companies report that their countertrade proposals are simply non-competitive. Of their lost sales, 82% went to foreign competitors , not to other U.S. companies. The major reasons include the strong support offered by other governments and their trade associations, and a greater agility of foreign competitors to absorb or dispose of the required countertrade goods.

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* "Assessment of the Effects of Barter and Countertrade Transactions on U.S. Industries" USITC Publication 1766, October 1985

⑧

U.S. companies recognize that the first requirement for competing today in the growing countertrade marketplace is their willingness to accept countertrade obligations. Having made this decision, many have found that it will allow them to retain their present market shares, or in some cases even enjoy additional business in new markets. Forty percent of the companies report that countertrade agreements provide them with a new marketing tool. It allows them to continue shipments of components or final products to their subsidiaries and distributors who otherwise would be cut off.

All companies are facing increased demands for countertrade. The most heavily requested, in 70% of the cases, is for counterpurchase of the client country's exports, either incremental or new. Other frequent requests include:

Joint venture or co-production agreements	49%
Transfer of technology	36
Buyback of products produced from machinery purchased from the U.S. supplier	26
Goods-for-goods barter	20
Equity investment in buyer's country	19

These growing requests come from over 65 countries, with most originating in 15 Latin American countries or in the Pacific Basin and Asian countries.

Is Countertrade Profitable ?

Two years ago a related study* sponsored by the National Foreign Trade Council noted that 32 % of U.S. companies involved were making a profit in countertrade sales, 50% were breaking even, while 18% reported overall losses. Today's study shows that 55% of U.S. companies are now enjoying profitable countertrade deals, 24% are breaking even and 7% report a loss. However, a significant 19% report their inability to determine what their net result is!

In striving for profitable countertrade sales, U.S. companies adopt various strategems. Over 50% absorb countertrade obligations within their own corporate structure: 35% within the U.S. and 18% at overseas locations. Another 25% of the companies receive assistance from either their suppliers or other U.S. exporters and importers.

Final disposition of the goods in some cases may be assigned to outside agents. Trading companies and banks are used by 50% of all companies at some time, while 12% find alternative solutions.

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* "A View of Countertrade" . A Study by The Countertrade Project in December 1983, sponsored by the National Foreign Trade Council Foundation.

If payment of a contractual penalty is the final option, 16% of the companies report paying penalties varying from 5-30%. A quarter of the companies avoid these penalties by arranging some form of alternative financing, e.g. á forfáit, clearing dollars, etc. A small group(6%) find relief in buying evidence accounts from other companies, while 4% report equity investments preclude paying penalties.

Do U.S. Companies Require Assistance ?

YES! Over 70% of the companies need additional help in solving their growing problems in countertrade. Only a few companies, those engaged primarily in domestic trade, report no need for assistance.

The most frequently sought forms of assistance are:

Availability of up-to-date CT marketing information	41%
Assistance in absorbing CT obligations	37
Access to CT credits unused by other U.S. firms	37
Availabilty of a national CT Resource Center	22

In addition to the above, many companies seek help in educating their own top management and staff in the intricacies of countertrade. Others need assistance in : constructing alternative financing schemes, locating key people in CT agencies abroad, and developing better cooperation between independent agencies in the buying country.

The need to develop an effective "watchdog" to monitor the continuing growth of countertrade, as well as its changing impact on U.S. industry, was strongly expressed by over 70% of the companies. 35% feel that the best solution is an industry-supported group, while 18% look to the government for this kind of assistance. Another 14% feel that some kind of private for-profit group is needed. Only 10% were confident of their own abilities to perform this monitoring task themselves.

While there is a clear majority for some kind of monitoring agency, no consensus exists on exactly what this group or agency should do. (See Table 2). HOwever, all companies agree that some revision of U.S. trade laws may be necessary to help U.S. corporations compete effectively in the CT marketplace. Again , what these changes should be is not defined.

However, if international, multilateral solutions are required, then U.S. companies expect Washington to play a dominant role, although they request close cooperation with industry in drafting any final proposals.

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Control Regulations Are Undesirable

When faced with the prospect of any group actually controlling countertrade, U.S. companies are in agreement. Half strongly express their belief that no steps should be taken to regulate countertrade. Their reasons vary from strong reluctance to see any additional government involvement in export activities to a firm belief in their own abilities to meet any kind of competition in this new kind of environment.

However, another group feels that some kind of measures should be taken to defuse the continued growth of countertrade in international commerce. Solutions proposed are both international and domestic.

The most frequently suggested international step is the creation of a restraining international code of conduct. This would be followed by standardization of countertrade terms, acceptable contracts and procedures; agreement on an international limit for the percentage buyback allowed; and establishment of arbitration procedures for countertrade agreements.

Three recommendatiosn in the domestic arena are: establishing a national Countertrade Resource Center; developing a centralized data bank; and furnishing assistance to U.S. companies that will fully equip them to compete with foreign sellers in countertrade proposals.

In Summary . . .

U.S. exporters identify over 25 important issues, concerns and needs they now face in dealing with growing countertrade demands. Those that stand out are:

The Developing Issues

A necessity to accept countertrade in order to compete overseas.

An inability to freely select overseas partners.

A pressing need to develop new marketing strategies.

Major Concerns

The probability that countertrade will continue to spread, particularly into more LDCs.

Fear that anti-countertrade or protectionist legislation will adversely affect the ability of U.S. firms to compete overseas, unless crafted with great care.

Pressing Need

> Increased access and availability to ever-changing information on the economic, political and regulatory retrictions on counter- in over 100 countries.

Finally, U.S. corporations seek a forum where they can freely examine common countertrade problems together. One which will help them create a support system equal to that existing in many other competing countries. Otherwise countertrade will continue to affect our balance of trade unfavorably.

This study was conducted under the direction of Willis A. Bussard, Director of The Countertrade Project and Executive Director of the U.S. Association of Countertrading Corporations. Additional information may be obtained from the USACC office at: 43 Sayre Drive, Princeton, New Jersey, 08540. Telephone: (609) 452-9266.

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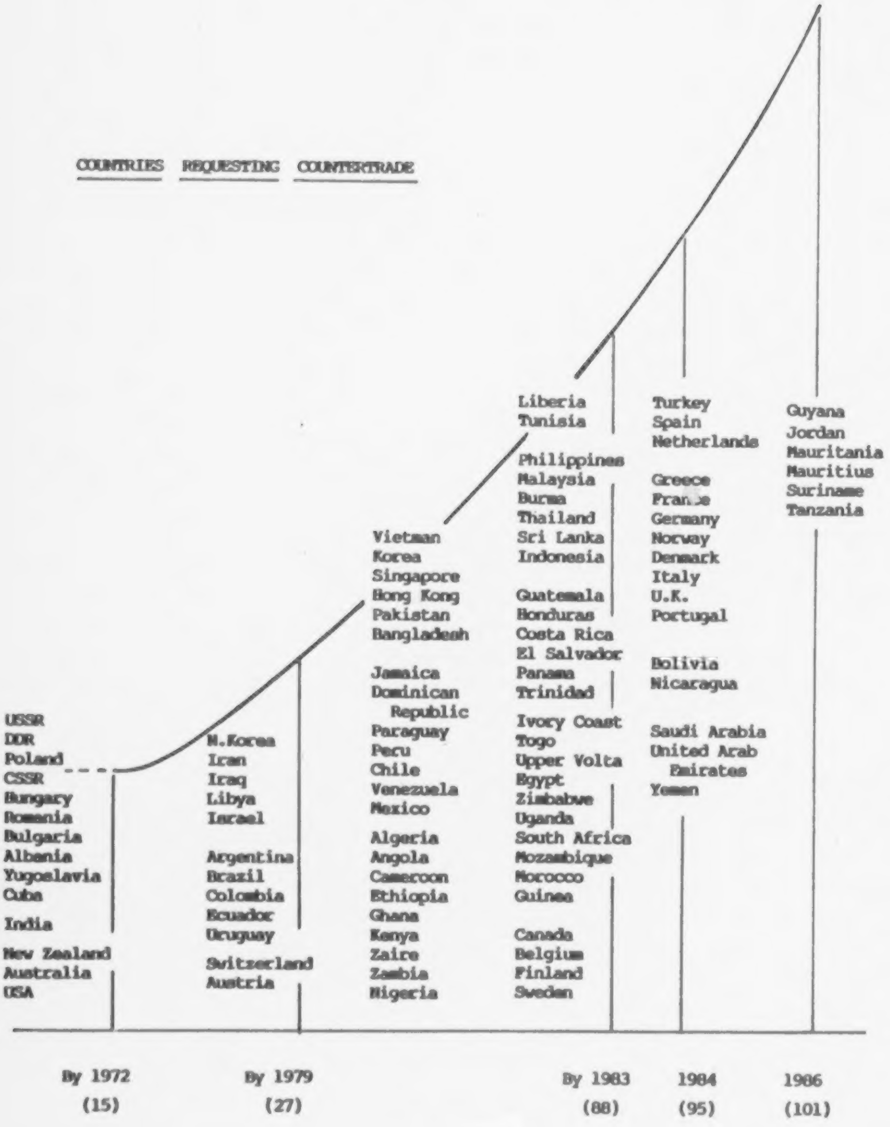
COUNTRIES REQUESTING COUNTERTRADE



STATEMENT OF JOHN PAUL, DIRECTOR OF GOVERNMENTAL AFFAIRS, AMAX, INC., WASHINGTON, DC, ON BEHALF OF THE AMERICAN MINING CONGRESS

Mr. PAUL. Thank you, Mr. Chairman. I am John Paul, director of governmental affairs for AMAX, and I am here today representing the American Mining Congress. The congress is a nonprofit corporation that represents the producers of most of America's metals, coal, industrial and agricultural minerals; manufacturers of mining and mineral processing machinery, equipment, and supplies; and engineering and consulting firms that serve the industry.

The American Mining Congress supports an open and fair international trading system. We believe in adhering to the principles of an open global economy, with free access to markets and resources; competitive and nondiscriminatory international trade, investment and project financing; and the strengthening of private enterprise worldwide.

However, today there exist many limitations to these principles and commitments, and we are therefore very pleased that the Finance Committee has initiated these proceedings to focus attention on a phenomenon that has become a major problem for the U.S. minerals industry—that is the proliferation of State trading. We are appreciative of the efforts of Senator Bentsen and yourself and each of the cosponsors of S. 2660 in seeking a solution to the trade-distorting practices of State trading enterprises.

The U.S. mining industry has been hurt severely in recent years by increasing activities of nationalized, State owned, controlled or subsidized mining and mineral producing and processing industries.

Mineral production is a major source of employment, national wealth, and hard currency for numerous less developed countries. Accordingly, the governments of many LDC's, as well as some industrialized nations, have acted to save or maintain mineral enterprises in the face of a depressed world minerals market. Such government assistance includes nationalization, provision of low-cost loans, and sometimes subsidization of production and exports.

These actions have contributed to an overproduction of minerals, which has exacerbated the price depression of the world minerals market and resulted in losses or inadequate returns to all producers, including those with State involvement. This places enormous pressure on the U.S. mining companies which also bear the very heavy costs of environmental and other regulations that often do not apply in these other countries. The inevitable outcome is that domestic U.S. producers are being driven from the marketplace, and our country is becoming more dependent on imports of vital materials in direct contravention of the declared national policy of fostering a strong domestic mineral base in the United States.

Article XVII drafted in 1947, recognized that State trading enterprises presented special problems for a world trading system that was being devised to restrain the actions of governments in order to free up the channels of international commerce for the benefit of private traders.

Accordingly, this article laid down the principle that State trading enterprises, in their importing and exporting activities, sh conduct themselves in a manner consistent with the GATT rules for private trading. They should, in their purchases and sales involving imports and exports, and I quote: "make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales."

In view of the time running out, Senator, let me just say that the AMC policy is very much in line with what we think your bill is attempting to do. You will note that the testimony does not address many of the specifics in your bill. That is for the very simple reason that the policy of our association is that we believe everything should be done to foster a new round and, in that round, that there should be very strong emphasis on the problem that your bill has raised. We do not have, at this time, policy positions that have been adopted by our board on some of the specifics within your bill. We will be addressing that in the next month when the board does meet, and we would like to work with you in the future in the development of the specifics of the legislation. Thank you.

Senator DANFORTH. Thank you, Mr. Paul. Mr. Hathaway.

[The prepared written statement of Mr. Paul follows:]

STATEMENT OF

JOHN H. PAUL, DIRECTOR OF GOVERNMENT AFFAIRS

AMAX INC.

representing

AMERICAN MINING CONGRESS

before

Subcommittee on International Trade

Finance Committee

United States Senate

August 6, 1986

I am John H. Paul, Director of Government Affairs for AMAX Inc., and I am representing the American Mining Congress. The American Mining Congress is a nonprofit corporation of the State of Colorado. It represents (1) producers of most of America's metals, coal and industrial and agricultural minerals; (2) manufacturers of mining and mineral processing machinery, equipment and supplies, and (3) engineering and consulting firms and financial institutions that serve the mining industry.

The American Mining Congress supports an open and fair international trading system. We believe in adhering to the principles of an open global economy, with free access to markets and resources; competitive and nondiscriminatory international trade, investment and project financing; and the strengthening of private enterprise worldwide. However, there exist today many limitations to these principles and commitments, and we are therefore pleased that the Finance Committee has initiated these proceedings to focus attention on a phenomenon that has become a major problem for the U.S. minerals industry--the proliferation of state trading.

We are appreciative of the efforts of Senator Bentsen, Senator Danforth and each of the cosponsors of S. 2660 in seeking a solution to the trade-distorting practices of state trading enterprises.

The U.S. mining industry has been hurt severely in recent years by the increasing activities of nationalized, state-owned, -controlled, or -subsidized mining and mineral producing and processing industries. Minerals production is a major source of employment, national wealth, and hard currency for numerous less-developed countries ("LDCs"). Accordingly, the governments of numerous LDCs, as well as some industrialized nations, have acted to save or maintain minerals enterprises in the face of a depressed world minerals market. Such governmental assistance includes nationalization, the provision of low-cost loans, and sometimes subsidization of production and exports. These actions have contributed to an overproduction of minerals, which has exacerbated the price depression in the world minerals market and resulted in losses or inadequate returns to all producers, including those with state involvement.

This places enormous pressure on U.S. mining companies, which also bear the heavy costs of environmental and other regulations that often do not apply to other countries.

The inevitable outcome is that domestic U.S. producers are being driven from the marketplace and our country is becoming more dependent on imports of vital materials in direct contravention of the declared national policy of fostering a strong domestic minerals base.

Article XVII - General Agreement on Tariffs and Trade (GATT)

GATT Article XVII, drafted in 1947, recognized that state trading enterprises presented special problems for a world trading system that was being devised to restrain the actions of governments in order to free up the channels of international commerce for the benefit of private traders. Accordingly, this article laid down the principle that state trading enterprises, in their importing and exporting activities, should conduct themselves in a manner consistent with the GATT rules for private trading. They should, in their purchases and sales involving imports and exports,

> make any such purchases or sales solely in accordance with commerical considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale, and shall afford the enterprises of other contracting parties adequate opportunity, in accordance with customary business practice, to compete for participation in such purchases or sales.

The administration of Article XVII has been almost nonexistent. No case has ever been brought before the GATT under this article. The GATT even had great difficulty in getting members to report on their state trading activities as part of a survey designed to effectuate subsection 4 of the article, which was added in 1955.

We, therefore, urge that action be initiated by the United States to help give meaning to the substantive rules of Article XVII and life to the principle that state trading activities undertaken for narrow internal reasons that create obstacles to world trade must not be condoned.

Fortunately, Article XVII itself provides a method of eliminating obstacles to trade created by state trading activities: negotiations. Article XVII.3 states that since state trading can be an obstacle to trade, "negotiations on a reciprocal and mutually advantageous basis designed to limit or reduce such obstacles are of importance to the expansion of international trade."

The full-fledged emergence of the aforementioned state trading in minerals and the scheduling of a new GATT round provide an opportunity for holding such negotiations. Congress, in any granting of negotiating authority for the new GATT round, should insist that our U.S. negotiators seek discussions with a view to reestablishing meaningful and market-oriented disciplines for state trading enterprises and eliminating many of the destructive activities that are now practiced in both developed and developing countries and that threaten the basis of the world trading system. A failure to address this problem now could be interpreted by the concerned LDCs as an open invitation to create further obstacles to world trade simply to further internal policies, which is inimical to the purpose of the GATT.

If no action is taken to achieve fairness in state trading, the GATT rules governing world trade largely become meaningless for the minerals industry.

A copy of the Resolution on Trade contained in the AMC Declaration of Policy adopted September 21, 1985, is attached and made a part hereof by reference.

We appreciate the opportunity to provide you with our views on the matter of state trading and its effect on the mining industry. We support the purposes of S. 2660 as a means to:

(1) implement international trade agreements controlling harmful mercantilist trading activities;

(2) prevent the establishment of burdens or restrictions upon the international trade of the United States by reason of mercantilist trading activities conducted by state trading enterprises;

(3) authorize trade negotiations to improve international trade agreements relating to mercantilist trading, and;

(4) improve remedies available under the laws of the United States for injury to United States persons resulting from mercantilist trading activities conducted by state trading enterprises.

STATEMENT OF DALE E. HATHAWAY, PH.D., PRINCIPAL, THE CONSULTANTS INTERNATIONAL GROUP, INC., WASHINGTON, DC, AND FORMER UNDER SECRETARY OF AGRICULTURE FOR INTERNATIONAL AFFAIRS

Dr. HATHAWAY. Mr. Chairman, I was asked to comment on the State trading in agriculture. It has always been of great interest to me that, even though in my view State trading is probably more pervasive in agriculture than almost any industry or sector, very little attention is paid to it.

It has been estimated by USDA and others that perhaps as much as 90 percent of the world wheat trade is handled on one side or the other by State trading agencies and as much as 60 percent of world coarse grain trade and a very high proportion of other traded agricultural goods also moves through State trading. This is not a phenomenon that is not limited to nonmarket economies, as it often is in some other sectors.

State trading also is pervasive in economies that are presumed to be market economies, varying from Japan and its food agency to Egypt and Algeria, all the way to the Soviet Union. As has been stated earlier in other contexts, the GATT rules really have very little relevance to what is going on and just are not effective in controlling the activities of these State trading groups in the agricultural sector.

Most of the discussion today, I think, centers on what happens when these entities sell in the U.S. market. In the agricultural sector, this is not the major problem.

The major problem, in my view, is what State trading does in third country markets and the ability of our exporters to compete with it. State trading is a very nice way of avoiding GATT rules on import controls. Countries don't put on import controls where they use State trading; they just say thank you very much; we are not interested in buying. That is a very effective import control. They don't use export controls; they say we are not interested in selling.

There is no transparency, and therefore you have no idea what pricing is in most agricultural transactions carried out by State trading organizations. Unfortunately, the problems are far easier to identify than are the solutions. It seems to me, because of the nature of the activities and where they occur, there are relatively few solutions that can be achieved unilaterally and that there is indeed a need for a substantial and serious reexamination of the GATT rules on State trading in agriculture.

I believe a number of U.S. agricultural groups are quite sympathetic and concerned about this. I do not know of any agricultural group that has a position on the issue as to how to deal with it. It is widely recognized as a problem and concern; but I have found relatively few groups that have any solution that seems to offer a significant improvement. Thank you.

Senator DANFORTH. Thank you, sir. Mr. Millian.

STATEMENT OF KENNETH Y. MILLIAN, VICE PRESIDENT, W.R. GRACE & CO., WASHINGTON, DC, ON BEHALF OF THE AD HOC COMMITTEE OF DOMESTIC NITROGEN PRODUCERS

Mr. MILLIAN. Mr. Chairman and committee members, I am Ken Millian, vice president of W.R. Grace & Co. I am testifying today on behalf of the Ad Hoc Committee of Domestic Nitrogen Producers in support of Senate bill 2660. Accompanying me are Shannon Shuman, an economist with Akin, Gump, Strauss, Haver & Feld and Phil Potter of Charls E. Walker Associates, counsel to our committee. We have filed a written statement with the Finance Committee. I would like to give an oral statement which will run about 7 minutes, if that is all right, Mr. Chairman.

Senator DANFORTH. Could you cut it down?

Mr. MILLIAN. I will try. [Laughter.]

Senator DANFORTH. If you could just summarize. In other words, anything you submit in writing will be automatically put in the record, and it will be reviewed. So, if you could sort of informally summarize your views, that would be appreciated.

Mr. MILLIAN. Before I begin, I think I can answer Senator Bentsen's question about how can we quantify the magnitude of the State trading problem. We are in the fertilizer business. Maybe that is a place to begin. Nonmarket economy imports now account for about 40 to 45 percent of the total U.S. urea imports. Last year, this was only 25 percent; and in 1981, it was 2 percent. So, if you are looking at state trading—at least in this market—obviously, there is a significant increase in the United States of State trading imports.

Our experience in the U.S. fertilizer industry qualifies, I think, our industry probably more than others to talk about this experience. The numbers show that. In supporting S. 2660, we do not seek protection for an outmoded industry.

The nitrogen industry in our country is as modern and as efficient as any in the world. We can compete against any producer paying unsubsidized prices and capital for materials. We cannot compete against State enterprises that do not.

Legislation like the bill that you gentlemen have introduced represents, in our view, an awakening. This awakening is long overdue. Direct competition with foreign State enterprises is a fact of life for U.S. industries. It is just not another factor for further consideration.

It challenges our basic assumption that world trade will increase on the basis of real comparative advantage and market forces. Today, we hope to focus your attention on all three basic factors which distinguish commercial from noncommercial considerations: Investment, production, and sales, not just price. The expansion of trade based on commercial principles is the foundation of GATT. As you said earlier, article 17 says in plain language that State enterprises must act in accordance with commercial considerations when engaged in world trade. It must be clearly understood that State enterprises encompass the investment in, production of, and sale of products. Any trade remedy must address this full range of potentially noncommercial State practices.

Our present trade laws, when viewed from this perspective, provide only piece-by-piece remedies. Our dumping laws, for example, address selling prices. Our countervailing duty laws are somewhat useful in addressing unfair subsidies at the production stage. In its current form, the test of commercial considerations in your bill, gentlemen, primarily addresses prices, like the dumping law.

Price is only the end result of the more comprehensive problem of noncommercial investment and production. A comprehensive solution is required that reflects the full scope of the commercial decisions that are made by commercial enterprise managers on a day-to-day basis.

U.S. private sector companies must operate solely on the basis of commercial principles by definition. I hope we are not here to debate whether that is legitimate or not. A commercial enterprise is defined as one which acts in a manner which seeks to ensure that it will be an ongoing business. For a commercial enterprise, revenues generated by the sale of goods or services must be sufficient to cover long term operating costs and continuously attract capital from investors at market rates. If private enterprise fails to do this, it faces bankruptcy. It will lose its investment. It is no more complicated than that.

However, on the other side of the fence, they don't play by those roles. They are more interested in getting a market share and getting hard currency.

Senator DANFORTH. Thank you, Mr. Millian. Mr. Verrill.

[The prepared written statement of Mr. Millian follows:]

STATEMENT OF KENNETH Y. MILLIAN
VICE PRESIDENT OF W.R. GRACE & CO.
ON BEHALF OF
THE AD HOC COMMITTEE OF DOMESTIC NITROGEN PRODUCERS
BEFORE
THE SENATE FINANCE COMMITTEE
UNITED STATES SENATE

August 6, 1986

Mr. Chairman and Members of the Finance Committee:

I am Ken Millian, Vice-president of W.R. Grace &. Co. W.R. Grace is a major domestic producer of fertilizers and chemicals, and is a domestically-based multinational corporation operating in 45 countries. I am here today on behalf of the Ad Hoc Committee of Domestic Nitrogen Producers. The Ad Hoc Committee, to which Grace belongs, represents approximately 50 percent of U.S. nitrogen fertilizer production. Grace is also an active member of the Labor-Industry Coalition for International Trade (LICIT) and the Petrochemical Trade Group (PTG). Both of these groups include the labor side of our industry, which is also concerned about the problem we are discussing today.

I am here to express our support for S. 2660, introduced by Senators Bentsen and Danforth, and co-sponsored by Senators Byrd, Boren, Roth, Domenici, Reigle, Heinz and Symms. S. 2660 addresses a problem which today threatens the survival of the U.S. fertilizer industry. That problem is the unfair competition that can arise as a result of the non-commercial investment, production and pricing decisions of state enterprises.

The U.S. fertilizer industry has experienced intense and increasing competition since 1978 from state fertilizer enterprises. It is fair to say that our industry has as much experience in competing with state-owned enterprises as any U.S. industry. We have also had as much experience as any U.S. industry in trying to obtain relief, under U.S. trade law, from unfair state trading. We know that improved remedies are sorely needed.

THE INCREASE IN STATE ENTERPRISE COMPETITION

All nitrogen fertilizers are made from ammonia, which is itself a widely traded nitrogen fertilizer. In 1970, about 43 percent of world ammonia capacity was owned or controlled by governments. Today, governments own nearly 68 percent of world ammonia capacity. It is estimated that governments will own or control 88 percent of the world's new ammonia capacity additions through 1990, increasing their share of total production to over 70 percent.

Urea fertilizer is produced directly from ammonia. According to international industry analysts, the world's urea capacity in 1985 would satisfy world nitrogen demand projected for 1990, but governments have announced plans to continue to add new capacity. These additions promise to aggravate the current oversupply problem which has been a major factor in driving ammonia and urea prices down below the cost of production in U.S. and free world markets.

In 1970, privately owned urea plants accounted for approximately 58 percent of world capacity. In 1973, governments gained majority control. In 1980, government ownership and control exceeded 63 percent. By 1985 it exceeded 70 percent, and is projected to exceed 75 percent by 1990. Over 92 percent of capacity additions through 1990 will be government owned or controlled.

These developments are paralleled in the world phosphate fertilizer industry. Today, governments own and control about 66 percent of world phosphate capacity. Ironically, the major competition to the U.S. industry, state enterprises operating in Morocco and Tunisia, were basically built from scratch by U.S. Ex-Im Bank loans. U.S. exports have been displaced by this new competition. Governments have also increased their share of the world potash industry.

Government ownership and control of another energy intensive industry, the petroleum refining industry, has increased dramatically since the 1970s. Governments now own almost 90 percent of the world's reserves of crude oil and an equivalent amount of the world's natural gas. These governments have established state enterprises to use oil and gas downstream. I mention this because the fertilizer industry and the petrochemical industry in the U.S. and most of the world is based on natural gas as both a feedstock and an energy resource. It is currently estimated that governments will control approximately 50 percent of the Free World's total petroleum refining capacity by 1987. When the non-market economy nations are included, government control over the world's refining capacity is overwhelming.

Although these figures highlight the dominance of governments in the world fertilizer industry and refining, I want to point out right away that government ownership or control of these enterprises is not necessarily or inherently unfair. This competition becomes unfair only when state enterprises do not operate on the basis of commercial considerations. When governments involved in world trade forego commercial considerations to achieve political and social goals, the result is injury to private sector producers. Unlike governments, private sector producers cannot forgo commercial principles and remain in business.

It is critical to note that state enterprise involvement in many basic industries has increased. The United States is virtually the only major trading nation which has resisted the nationalization and state enterprise trend. In developing countries, state enterprises have been used to build up basic infrastructure. In many developed countries, state enterprise has been used to save failing basic industries. In nations such as Canada, Japan, West Germany and others, the economies are still private sector oriented, but the emergence of state enterprises in these economies is increasing. We cannot reverse this trend, but we must deal with it.

In Nationalized Companies: A Threat to American Business (Monsen and Walters, 1983, McGraw Hill Book Company, p.1), which Mr. Verrill refered to in his testimony, the authors state:

> As recently as 1970, not a single manufacturing industry in which state-owned firms held an important share of industrial output could be found in Western Europe. That has now changed radically. In a number of industries, state-owned firms have gained a dominant, or significant, position in European markets. The list includes some of the most important industrial sectors, including aerospace, steel, aluminum, shipbuilding and automobiles.
>
> Today state owned firms can be found in virtually all industries in Europe. New state firms in the 1970s were created or nationalized in pharmaceuticals, electronics, computers, office equipment, oil, microelectronics, chemicals, petrochemicals, pulp and paper, and telecommunications. Each year more firms are drawn into the state-owned sector. In addition, many state-owned firms have embarked on a strategy for international expansion and diversification. Now many of the top foreign multinationals are owned and controlled by their governments.

Concerning Western Europe, recent events in France may portend a trend away from excessive nationalization of industries. The French economy suffered setbacks under the nationalization program of the Socialists and is now moving to de-nationalize some industries. This is a heartening development, but it does not change the basic situation that has developed in Western Europe.

Reviewing the August 4, 1986 list of the Fortune International 500, many state-owned companies are now listed in the top 50 industrial concerns. Refering to state owned companies, Fortune says, "It seems easier for state owned companies to grow big than to make money." Discussing a state owned steel company whose poor performance caused its chief executive and entire board of directors to lose their jobs, Fortune says, "The moral may be that not even a state will support bad business judgements indefinitely." There is a critical point here. The state may replace the directors of a state owned company, but it will not allow the company to fail.

Non-commercial actions by state enterprises can have profound consequences regarding the production of and trade in commodity products -- products which are produced in similar fashion all over the world and largely undifferentiated by quality, and which compete on the basis of price. If a state enterprise is made more competitive because the state provides natural resources or capital or other preferential assistance which sustains it as an ongoing business, other producers will be unfairly disadvantaged. The key consideration in international trade is that enterprises should act in a manner which allows them to recover all economic costs and the replenishment of capital through commercially-sound transactions.

If the United States is to maintain its key basic industries and promote a world trading system based on market forces, it is imperative that the U.S. private sector economy be shielded from unfair, non-commercial state trading. If the U.S. government does not promote and defend market principles, the result will be an increase in unfair trade complaints from U.S. industries. Piece-meal resolution of specific complaints will fail to resolve the basic problem of private-state competition.

GATT ARTICLE XVII ON STATE TRADING MUST BE EXPANDED AND CLARIFIED

The principle of world trade based on commercial considerations is explicitly set forth in Article XVII of the General Agreement on Tariffs and Trade (GATT). Article XVII specifically addresses state trading and says that state enterprises engaged in world trade must "act in accordance with commercial considerations." My testimony will complement Mr. Verril's, which focuses on the legal aspects, and will provide additional examples of state enterprises which have used sovereign powers to gain an unfair advantage over private producers.

THE IMPORTANCE OF S. 2660

S. 2660 proposes to address unfair state trading with a three-pronged remedy. S. 2660 would make unfair state trading an unjustifiable practice under Section 301 of the 1974 Trade Act, explicitly granting power to the President to negotiate with other governments involved in state trading. It would establish a remedy against unfair state trading modeled after Section 337, which would allow the U.S. to establish quotas on unfairly-traded imports, or, if necessary, to exclude these imports altogether. Finally, S. 2660 would mandate the negotiation of GATT provisions which will better define non-commercial practices in order to establish an international consensus on unfair state trading.

Article XVII was established in 1947, before state trading was an integral -- indeed dominant -- factor in international trade. It is long past time to clarify and develop Article XVII to conform international rules and U.S. trade law to modern conditions.

It is clear that if the United States does not take the lead in clarifying unfair state trading practices, under its own law and under the GATT, then further GATT negotiations on this crucial issue are doomed to failure. In the non-market economies (NMEs), the developing countries and many developed economies, state ownership, control and influence over industries has increased and will continue to increase.

CURRENT U.S. TRADE LAWS DO NOT SUCCESSFULLY ADDRESS NON-COMMERCIAL STATE TRADING

Beginning in 1979, the nitrogen fertilizer industry first attempted to address its specific problems with state enterprises through Section 406. During the 406 case, the Ad Hoc Committee reviewed with the Administration the possibility of using Section 201, but it was deemed inappropriate; the unfairly-traded imports were primarily from NMEs, and Section 201 would unfairly penalize foreign producers that do not trade unfairly.

The 406 case demonstrated the problems inherent in 406 very clearly. The International Trade Commission ruled in our favor by a 3-2 vote on market disruption and recommended to President Carter that quotas be imposed on Soviet ammonia imports for three years. The President refused to follow the ITC recommendations as not in the economic interests of the United States. About three weeks later, the Soviets invaded Afganistan and the President imposed a grain and fertilizer embargo on the Soviets, and sent the 406 case back to the ITC. In the interim, a new Commissioner joined the ITC and the second vote came back 3-2 against market disruption. In brief, the political component of Section 406 has established its reputation with U.S. business as an unworkable remedy.

In 1982, the Ad Hoc Committee filed a countervailing duty (CVD) case against Mexican ammonia imports, specifically addressing upstream subsidies and natural resource subsidies. We discovered that such subsidies are not effectively addressed under the CVD law. The Commerce Department, using its "generally available" rule, which is absolutely not contained anywhere in the GATT or in the U.S. Subsidies Code, said that there was no countervailable subsidy provided because the subsidy was not provided to a "specific industry or group of industries." Essentially, the actions of PEMEX were legal because they subsidized all energy intensive industries in Mexico. Of course, Commerce did not care that the industries causing trade problems were completely controlled by PEMEX or that PEMEX refused to make its low domestic price available to other willing buyers on every count.

Fortunately, the Court of International Trade recently said that Commerce could no longer use its "generally available" invention as the sole determinant in CVD cases, for the simple reason that this flawed test does not take into account the effect of the subsidy.

This absurd ruling under the CVD laws, and similar rulings in other cases, led to the formulation of the natural resource subsidy proposal contained in S. 1292. Similar legislation is contained in H.R. 4800. The natural resource subsidy provision in H.R. 4800 was passed overwhelmingly by a 338-79 vote. In this vote, a very clear majority of Republicans joined the Democrats for passage despite Administration opposition.

An Ad Hoc Committee company also filed a Section 337 case against Mexican ammonia in 1982 on the theory of restraint of trade, which was rejected. We also reviewed with the Administration the use of the antidumping laws on imports from state-enterprise sectors of market economies, such as PEMEX in Mexico. Like the CVD laws, the antidumping laws would not effectively account for the subsidies on material and capital inputs.

As I explained in my letter of July 25, 1986 to the Finance Committee, we felt we had no choice but to file an antidumping petition in order to avoid further confusions, problems of discretion and delays. We filed the petition on July 16 against urea imports from three NME nations -- the Soviet Union, Romania and East Germany. Our first preference was for USTR to self-initiate Section 301 cases under Article XVII of the GATT. The Administration deferred filing 301 cases, clearly indicating that these cases should be first brought under the antidumping laws.

On June 26, we testified before this Subcommittee on the problems with the dumping laws with regard to NMEs. We explained in that testimony why Sections 406 and 201 remedies are still ineffective and inappropriate to address NME trade problems.

Concerning the CVD laws, Commerce has remained firm in refusing to apply them to non-market economy cases. However, the Court of International Trade recently ruled that the CVD laws are applicable to NME nations. However, Commerce has not enforced this ruling pending disposition of its appeal to the Court of Appeals of the Federal Circuit.

The major problem we see for our dumping cases is the Commerce Department's preference for using price methodology over either the "factors of production" approach or the "constructed value" methodology in surrogate countries. In these cases, Commerce's preference for price methodologies renders the dumping laws little better than Russian Roulette. Urea prices are already depressed in virtually every major market that could appropriately be considered a potential surrogate. Urea prices are depressed in North America, Western Europe and the Far East. We have similar concerns over the priority established in S. 2660 on the test of commercial considerations.

As we pursue these antidumping cases, we continue to analyze the considerations presented in our testimony today. Spain has filed an escape clause case on urea imports and has gotten immediate quotas on EEC imports. The investigation on imports from non-EEC sources is now under way. We are following these developments closely because it appears that Spanish and other Western European producers are also being adversely affected by very low-priced urea imports from the Soviet Union, Romania and East Germany.

We will keep the Senate Finance Committee advised of the progress in our case. It suffices to say that we are taking a Missouri "Show Me" attitude toward the Commerce Department and the ITC, as well as towards USTR and the rest of the Administration.

We strongly urge the Finance Committee to adopt our recommendations on amendments to the NME dumping laws. We also urge the committee to support passage of S. 1292 on natural resource subsidies, which is also contained in H.R. 4800. We also support H.R. 4800's CVD amendment which combines the subparagraphs on domestic subsidies on capital, goods and services. However, this proposal should be amended by the Senate to make it clear that external benchmarks should be used by the Commerce Department in determining whether capital, loans or loan guarantees, or goods and services are provided at preferential rates or on terms inconsistent with commercial considerations. Finally, the Committee should adopt the amendment on material injury in the case of "fungible goods" -- commodities -- in H.R. 4800. This amendment would clarify and correct inconsistent findings of injury by the ITC on cases involving commodities.

S. 2660 is not a substitute for these proposals. Nor can these other proposals resolve all the problems presented by state enterprises which trade in a non-commercial manner. Legislation like S. 2660 is a necessary supplement to these new proposals. I trust this will be made clear in the rest of my testimony.

IMPORTANT CONSIDERATIONS ABOUT STATE TRADING

In a world characterized by a free and open trading system, the managers of industrial enterprises -- whether controlled by governments or private interests -- would make investment, production and pricing decisions in response to market forces. These decisions would be based solely on their commercial feasibility.

In trade sectors characterized by government ownership and management, the investment, production and pricing decisions may be undertaken to achieve political goals as well as economic goals. Commercial feasibility, as it is understood by private producers, may be sacrificed for the "greater" political considerations of governments. These "greater" considerations range from maintaining employment and inefficient industries to increasing exports and protecting infant industries from import competition.

Although many considerations must be taken into account, they must not cloud the basic problem: when governments allow politics to override sound commercial principles, trade based on comparative advantage and market forces is endangered. The seeds of this regression have already been planted.

- In the non-market economies, governments attempt to pre-determine economics under long-range plans. These economies are known as "command economies" because central planners determine supply, demand and price of goods --usually years in advance.

- In Western Europe, different nations have taken different approaches; numerous enterprises have been nationalized, either for the purpose of saving them from extinction or for the purpose of concentrating their economic power.

- In the less-developed countries, government control over industries has been justified by national imperatives, including protection from economic colonialism. While perhaps unavoidable, state enterprise has failed to produce needed growth. This has resulted in increasing desperation over the debt problem. The debt problem is at least partially due to attempts to sustain inefficient state enterprises. This has been partially dealt with under the Baker Plan, which calls for the privatization or elimination of state enterprises in order to establish business and government practices based on sound commercial principles.

- In a number of nations, state enterprises control the prices of key natural resources, including oil and natural gas. In certain nations -- most notably Mexico, OPEC nations and the non-market economies -- oil and natural gas are provided at below market rates to domestic users, but may be exported at higher market-based prices to other nations. In some cases, access to the resources at the lower price is simply barred. Market forces would not create preferential, discriminatory pricing systems. This government activity can disrupt foreign markets and protect domestic industries from import competition.

- State-owned or influenced banks provide capital to domestic industries at preferential, below-market rates which are not available to private producers borrowing money on commercial terms from banks.

COMMERCIAL CONSIDERATIONS

Fundamentally, a commercial enterprise is one which acts in a manner which seeks to ensure that it will be an ongoing business. For a commercial enterprise, revenues generated by the sale of goods or services must be sufficient to cover long-term operating costs and continuously attract capital from investors. If the commercial enterprise fails to do this, it will face bankruptcy.

The state enterprises of concern today are those which are dependent on continuing government assistance to ensure their ongoing existence. Such an enterprise will not be allowed to fail or go bankrupt if its revenues do not recover operating costs and ensure replenishment of capital over the long term. Instead, it will be subsidized by the state in any number of ways, including covering losses or the provision of capital and materials at subsidized rates.

The term "commercial considerations" basically means that investment, production and pricing decisions are determined by market forces of supply and demand. Essentially, the price of a good is the result of these decisions. In developing trade law to address state trading, legislators should primarily be concerned with the investment, production and trading activities of state enterprises as opposed to the dumping or subsidization of specific goods from a particular nation. This is because the price of the finished good may reflect prior non-commercial decisions of the state enterprise. For example, simply comparing the price of urea from a state enterprise with prices from private enterprise may not reveal the non-commercial actions of the state enterprise. Maintenance of excess capacity to produce a commodity which does not recover its full economic costs may depress prices in world markets. The larger process must be investigated.

STATE TRADING AND THE PROBLEMS IT CAN CREATE

We are principally concerned with export competition by state enterprises which use government power and influence to intervene in the operation of market forces in ways which injure private producers. If such intervention results in the lowering of production costs, absorbs a portion of production costs, or absorbs losses directly or indirectly, then it permits a state enterprise to export to U.S. or third-country markets at lower prices than would be possible based on commercial considerations. Such actions either maintain or increase production of the state enterprise, and add supply to the market which would not be added on the basis of commercial considerations. U.S. producers then suffer losses or lower returns on investment due to prices which are insufficient to sustain the U.S. producer as an ongoing business.

The simple fact is that state enterprises may not be required to make a profit. Once an enterprise is nationalized or established by the state, experience clearly shows that it will continue to be operated whether it is profitable or not. The political imperatives of state ownership -- maintaining employment, increasing exports, protecting home markets from import competition, and in the case of the NMEs, exporting to obtain hard currencies -- override market forces.

State trading is characterized by government ownership, control or influence over production. The state is involved in the decision to provide capital to build a plant and its subsequent management. The state is also involved in determining production and the price at which products will be sold. State trading may directly involve agencies or instrumentalities of a government. It may also involve enterprises owned or controlled in such a manner that the government exerts substantial control to influence the investment, production and pricing decisions of enterprise managers. State trading may also involve enterprises which are not owned or controlled by the government, but subject to government influence through the granting of special or exclusive priviledges.

In some cases, state trading will involve "gray areas." However, GATT Article XVII clearly contemplates that:

1) a government may grant a concession or exclusive privilege to an enterprise -- government or private -- to exploit national natural resources, so long as the government does not exercise any control over the trading activities to distort the enterprise's decisions on investment, production and pricing;

2) a "tied loan" (such as an Ex-Im bank loan) may be taken into account as a commercial consideration in government purchases of goods or services abroad, so long as the loan terms are commercial. If not, both the lending government and the purchasing government may be engaging in unfair state trading if other sellers are excluded from the transaction as a result.

EXAMPLES OF STATE ENTERPRISES ENGAGED IN NON-COMMERCIAL AND UNFAIR TRADE

The Nitrogen Problem and the NMEs

Private industry analysts, the Commerce Department and the World Bank agree that 1985 capacity to produce urea fertilizers exceeds 1990's projected demand.

In 1980, world urea production capacity was 29,122,000 short tons of nitrogen content, or "N" (nitrogen fertilizers like ammonia, urea and solutions are characterized by their nitrogen content). World urea demand was estimated at 22,978,000 short tons N. Capacity utilization required to meet world demand was only 78 percent. This represents substantial overcapacity.

In 1985, world urea capacity had increased 36 percent, to 39,606,000 short tons N. Total world demand had increased 35 percent, to 31,030,000 short tons N. Capacity utilization required to meet demand remained at 78 percent.

World urea capacity is prjected to increase to 51,353,000 tons N by 1990, an increase of over 29 percent. Demand is expected to increase to 38,200,000 tons N, up 23 percent. Capacity utilization required to meet demand would drop to only 74 percent.

In brief, 1985's capacity of 39,606,000 short tons N will exceed 1990's projected urea demand of 38,200,000 short tons N. Only 2,800,000 short tons N of new capacity would be requried over the five-year period to achieve a 90 percent capacity utilization. Yet 11,500,000 tons of new capacity is scheduled. Almost 9 million tons of existing capacity would have to be closed, or that much of the scheduled new capacity deferred, in order to balance supply with demand. The alternative is to utilize world capacity at less than 75 percent, an inefficient and uneconomic rate.

Soviet Union -- Nitrogen Fertilizers

Between 1980 and 1985, the Soviet Union increased urea capacity from 3,223,000 short tons N to 6,010,000 short tons N, an increase of over 86 percent. Soviet export of urea were estimated by be 1.5 million short tons N in 1985, or 25 percent of nameplate capacity. If Soviet capacity utilization rates are below 80 percent, as is generally thought, then Soviet exports were over 30 percent of production.

The Soviets have built up huge apparent surplus capacity and are exporting its production at whatever price is available in world markets -- primarily the U.S. and Western Europe. The Mining Journal, Ltd reported in 1985 that the Soviet Union was increasing nitrogen fertilizer exports, mainly in urea, which more than doubled between 1980 and 1983. The Soviets underwent a massive expansion of urea capacity in the last seven to eight years which is almost complete. The Journal reported that this increased Soviet exportation had coincided with a slump in international urea prices. The Soviets are projected to increase urea capacity by another 2 million tons N by 1990, an increase of almost 33 percent. Several million tons of new Soviet ammonia capacity were also recently announced.

Eastern European countries are projected to increase urea capacity by 1,138,000 short tons N, or almost 30 percent, by 1990. The combined increases of these NMEs of over 3,100,000 short tons exceeds the amount of capacity additions necessary to balance supply with demand at efficient utilization rates.

U.S. urea capacity grew only 1 percent during 1980-1985, while several million tons of ammonia capacity have been permanently shut down due to price depression. There are no net capacity additions planned in the U.S. between now and 1990. The actions of U.S. producers are in sharp contrast to those of the NMEs.

The Soviet Decision-making Process

Basic investment decisions to increase production are made in five-year plans, primarily by GOSPLAN and the Politbureau. The basic decision to increase petrochemical production capacity, including nitrogen fertilizer capacity, was made in the 1970-1974 Plan. It called for the acquisition of turnkey ammonia plants, based on Western technology. The technology was principally that of the Kellogg Company of Houston, Texas.

Most of the plants were completed during the next five-year plan, ending in 1979. The plan also called for significant urea capacity, which was largely installed during the 1980-1984 period. Excess capacity for export of both ammonia and urea was apparently included in these plans. Countertrade deals were negotiated in many instances to pay for the plants and the necessary infrastructure improvements, including technology, storage and port facilities.

Nitrogen fertilizer exports to the U.S. commenced in 1978 and have increased ever since. At first, ammonia was the principal product. Urea exports effectively got underway in 1981-1982, after initial difficulties with operating facilities and quality control. Despite the export of perhaps 30 percent of total capacity and the glutted condition of the world market, additional urea and ammonia capacity is scheduled for installation during the next five year plan, 1985 through 1989. Oversupply has depressed both ammonia and urea prices over the last year and shows no signs of abating even before the addition of this new export-oriented capacity.

Under the NME system, it is clear that the "investors" are not in charge of production. These investors include the countertrade partners in the West. NME production managers have no control over costs of production inputs or final prices because these factors are also predetermined by GOSPLAN. The recovery and replenishment of capital are not primary considerations in the new investment and pricing decisions. Production quotas are the principal concern of plant site managers.

The bifurcation of these initial decisions is compounded by the separation of the export trading company from the production process. The Trade Ministry sets export quotas and goals, primarily seeking volume and hard currency earnings. In some instances, export organizations may be given a range of volumes to meet specific hard currency goals. If prices in world markets drop, the export organization may export more product to make up lost revenue with volume. The effect of this action in a commodity market is to further depress prices. Although ammonia and urea are largely interchangable products for their farm customers, and although their prices necessarily affect one another, and although both are produced at the same plant locations due to the compatibility of production processes, ammonia and urea are exported by different organizations. Again, export prices and volumes are not the responsibility of the production site.

To further complicate matters, the Trade Ministry may negotiate countertrade deals through separate importing and exporting organizations. The only common enterprise is usually the Western trader, who barters one product for the other. The Trade Ministry generally negotiates the prices and volumes of imported products and the exported barter products. The trading organizations are then given volumes and prices by the Ministry, and conclude deals on those terms. While these appear to be separate transactions on the surface, they are in fact tied together.

In many instances, export volumes and prices are negotiated once a year. Yet the world market in ammonia and urea may vary widely in terms of demand and price during that time.

It is plain that this set of disconnected decisions can result in disruption and price depression in commodity markets. Disruption has increased over the last year due to NME urea exports to the U.S. and Western Europe, probably because the decline in oil prices has cut the Soviets' major source of hard currency and stimulated the export of products like urea. Soviet natural gas prices have also been forced down by the decline of oil prices, and revenues realized from the Soviet-European pipeline have been significantly eroded. In attempting to make up lost revenue, however, the NMEs have completely disregarded the condition of demand and supply in Western nitrogen fertilizer markets.

A similar process is occuring in Romania, which is distorting its domestic economy to increase urea and other exports to gain hard currency to repay debts to the West.

Another problematic result of the central planning function is that the forecasts of the planners do not always come true. The failure of one economic sector will influence the production and distribution of another economic sector's output and can result in market distortion outside of the centrally-planned economy.

For instance, suppose that the Soviet Union decides to build ten new ammonia fertilizer plants to support a certain targetted increase in the production of corn and wheat over a period of five years. This might also entail the necessity of improving the transportation infrastructure of roads and vehicles in order to move the fertilizer to the fields and remove the harvest to storage. Now, suppose that the fertilizer plants are successfully constructed, but that either the agricultural output or the infrastructure improvements fail to meet their goals. In this case, large quantities of excess ammonia-based fertilizers are produced with no ability to use them in the domestic market. The excess nitrogen will then have to be exported into world markets.

Since nitrogen fertilizers are commodities, excess supplies in world markets will drive down prices. The Soviet trading company will move this product by continuously dropping its price under that of its nearest competitor to ensure sales. Private producers will also have to drop prices to compete. Over time, the depressed prices will cause private producers to leave the market.

Petrobras and Interbras -- Brazilian Ethanol

The export of ethanol from Brazil is another example of non-commercial state trading. Brazil's state oil company, Petrobras, buys ethanol from private producers. That production is subsidized to some extent. Petrobras sells the ethanol in Brazil and also to Interbras, its state trading arm. In a recent dumping case, Interbras was found to be selling ethanol in the U.S. at a price substantially below its purchase price from Petrobras, by about 119 percent. A private Brazilian trading company was also selling ethanol in the U.S., but not below its acquisition cost.

Obviously, Interbras was incurring a loss. Interbras was able to do this because it received ongoing capital infusions from Petrobras in order to continue its export business. Yet the Department of Commerce found that this continuing capital infusion was not a countervailable subsidy.

PEMEX and Mexican Ammonia

An example of a nation which uses state enterprise to lower production costs of both state-owned and private companies is Mexico. Petroleos Mexicanos (PEMEX) is a government instrumentality, granted the exclusive privilege to produce, sell and export all Mexican energy resources. PEMEX is also the exclusive producer of all basic petrochemicals, fertilizers and refined petroleum products (a separate state owned utility produces and sells all electricity, but it buys its fuels from PEMEX).

The Finance Committee is familiar with the CVD case filed by the Ad Hoc Committee against Mexican ammonia imports in 1982. It was one of the cases which sparked controversy over the "generally available" rule and resulted in the drafting of S. 1292 on natural resource subsidies. The state trading practices of PEMEX are much more extensive, however, and illustrate the deficiencies in both CVD and antidumping laws to deal with unfair state trading.

In September, 1982, PEMEX sold natural gas to all industrial users in Mexico at a U.S. equivalent price of $.52/mcf (at 25 pesos to the dollar). The bulk of Mexican natural gas was used by PEMEX and the state electric utility. PEMEX exported natural gas to the U.S. at $4.40 per mcf, which wac equivalent to the Canadian border price for gas at that time. In addition, PEMEX was flaring gas rather than exporting it to the United States for a lower market clearing price. The lost gas export revenues alone exceeded PEMEX's total revenues on ammonia sales.

PEMEX's cost of gas production was determined to be less than $.52/mcf at the Preliminary. The Commerce Department found the difference between PEMEX's cost of gas and the industrial use rate it charged to other Mexican industrial users to be a countervailable subsidy. However, DOC determined that the difference between the $.52/mcf gas and its export price or its fair market value was not a countervailable subsidy.

PEMEX also sold ammonia and urea in Mexico for far less than its export prices to the U.S., which were also well below its full production costs. It also sold refined products at domestic prices substantially below their export values or fair market values. PEMEX simply reported its total revenues for ammonia and gas sales with its other sales, including crude oil, refined products and other petrochemicals, and subtracted its total costs of production.

Overall, it made a profit, but there is serious question whether it profited on ammonia. It certainly did not recover its opportunity costs on gas and ammonia. PEMEX generally charged itself a LIBOR rate for capital costs, but used longer depreciation rates than were normal for the industry. Its unrecovered costs, losses and inefficiencies were masked by its oil revenues. Its taxes essentially equalled its gross revenues less its direct costs. Those revenues went to the Treasury to cover other government costs.

Mexico has since raised its internal gas price in pesos so that its current industrial user rate is about $1.72 per mcf. It has terminated all gas exports since 1983. PEMEX's current lifting and processing costs for natural gas, plus transportation to its ammonia plants, are estimated at about $.45/mcf. Under the previous CVD case, PEMEX might be found to be subsidizing its ammonia production by $1.27/mcf ($1.72 - $.45), or about $48 per ton of ammonia. If PEMEX were charging itself the industrial user rate for natural gas, its gas costs per ton of ammonia would be over $65 per ton. At PEMEX's current export price for ammonia, the price FOB plant in Mexico is no more than $70 per ton.

On a constructed value basis, PEMEX appears to be dumping. Other cash costs, depreciation, overhead and profit would clearly exceed $5 per ton. However, constructed value under the dumping laws would recognize only the $.45 per mcf gas cost which equates to only about $17 per ton of ammonia. Thus, PEMEX might not be found to be dumping.

Neither antidumping or CVD law would address the rest of the non-commercial transactions engaged in by PEMEX. Such transactions follow a general pattern engaged in by many state owned oil companies.

Morocco and Tunisia -- Phosphate Fertilizer

The U.S. has some of the largest phosphate deposits in the world, mostly in Florida and the Southeast. The U.S. industry is among the most efficient in the world. Historically, nearly half of its production is exported in the form of phosphate rock, phosphoric acid, and, when mixed with ammonia, ammonium phosphates.

For political foreign policy reasons, the U.S. Department of Commerce promoted the development of a phosphate industry in Morocco and Tunisia. These nations had no infrastructure or technology to support such an industry. Yet Morocco and Tunisia established state enterprises and negotiated World Bank and U.S. Ex-Im bank loans to purchase technology and equipment to mine and produce phosphate fertilizers. The value of these loans since 1980 is estimated by industry analysts to have exceeded $200 million.

As a result, world phosphate capacity now greatly exceeds demand. Eight U.S. phosphate plants are shut down and seven more are running at partial capacity. Thousands of U.S. workers have lost their jobs.

U.S. phosphate producers argued that such production would be uneconomic under current and projected market conditions, simply creating excess capacity and driving down phosphate prices. The export value of the U.S. technology was minute compared to the export value of U.S. phosphate products.

The Fertilizer Institute (TFI) will outline the problems in the phosphate industry and competition with state owned enterprises in phosphate rock trade.

Saudi Arabian Joint Refining Ventures

My final example involves the joint venture refineries in Saudi Arabia. The investment decisions to build these refineries were made in 1979 and 1980, when oil cost $35 per barrel and was projected to rise to $70-$80 per barrel by 1986.

A recent report by the East-West Center in Hawaii concedes that these projects can barely recover operating costs, even using $.50/mcf natural gas refinery fuel, with oil prices now at $10 per barrel. They cannot recover any return on investment.

The Mobil/Petromin joint venture refinery at Yanbu also has apparently received concessionary financing and tax holidays from the Saudi government. There are also other non-commercial aspects of financing in Saudi Arabia which affect most of its industrial energy-based complex. The Yanbu refinery was designed to export high volumes of unleaded gasoline to the United States. Yet the refined products from the Saudi export refineries are at best marginally competitive in the U.S. market at today's prices, and then only if no return on investment is expected.

Other Noteworthy Examples

A world scale methanol plant was constructed on Bunyu Island in Indonesia. According to a Commerce Department study, this plant could not recover its construction costs by selling methanol in the glutted world market even if natural gas were given to the plant for nothing -- zero cost. Yet the World Bank funded the project. Most U.S. methanol plants have been shut down by low prices. An ammonia complex is scheduled for construction on the southern tip of Chile. Even with a zero input cost for natural gas, the plants are unlikely to ever recover their costs.

STATEMENT OF CHARLES O. VERRILL, JR., ESQ., WILEY, REIN & FIELDING, WASHINGTON, DC; ON BEHALF OF THE AD HOC COMMITTEE FOR DOMESTIC NITROGEN PRODUCERS, AND CHAPARRAL STEEL CO.

Mr. VERRILL. Thank you, Mr. Chairman. I am Charles Verrill of the law firm of Wiley, Rein & Fielding. I am pleased to be here today to comment on S. 2660. This bill would, for the first time, directly address what I think everybody acknowledges is the growing phenomenon of trading by State enterprises in disregard of the commercial obligations imposed by article 17 of the GATT.

The USTR recognizes state trading as a problem and has proposed that the agenda for the next trade round of negotiations include a proposed code which would specifically address what is meant by the commercial obligations of this article.

I agree with this objective, but I also think that legislation at this time would be appropriate because the problem is in need of a present remedy, not a distant GATT resolution. In my prepared statement, I give a number of instances or examples of State enterprise trading. What is particularly disturbing in many of these examples is the fact that the distortions resulting in the marketplace from the State trading activities are not ordinarily remediable under the antidumping and countervailing duty laws. To the extent those laws apply, they should, of course be imposed; but often those laws do not apply to State enterprise trading. That is the reason why legislation to implement the commerciality obligation of article 17 is now essential. It is going to be years before the contracting parties conclude the GATT round, if at all; and I think the action by the United States to give content to that article would be an enormous aid to negotiations.

With respect to the proposed legislation now before the committee, I have some specific comments that are detailed in my prepared statement and which I would now like to quickly summarize.

First, the type of enterprises to which the bill should apply is in need of modification. GATT article 17 specifies three kinds of enterprises which are subject to its obligations. State organizations such as purchasing and selling ministries and the like are specifically addressed by article 17. In my opinion, article 17 clearly includes within this definition the nonmarket economy trading enterprises. I have carefully analyzed the documentation that accompanied the adoption of article 17, and it is clear that this article was intended to apply to the nonmarket economies as well.

Second, the bill should apply to State-controlled companies whether or not they have any special favor from the Government; and, third, private companies that do have such special favors should also be covered.

The commerciality standard in the proposed legislation relates essentially to normal value or the cost of production of a specific product as defined by the antidumping law. This is fine, but it does not go far enough.

The normal value test will not be sufficient to remedy State trading where world prices are depressed by overcapacity or where the enterprise benefits from hidden subsidies that give the artificial appearance of sales above the cost of production. We believe that "commerciality" is a larger concept than "??? value" as defined in the antidumping law and should be defined in the bill in the alternative; the definition should consider prices whether "normal" or based on costs of production. However, even where prices have the appearance of "normality" the administrating anthority should consider evidence that the state enterprise involved has adversely affected world prices by excessive production such as where a State enterprise has developed capacity without any expectation of reasonable return over the long run. Other tests may also be appropriate. The crucial point is whether these State enterprises operate to achieve State welfare goals as the primary objective and not a commercial objective. This is the essence of "commerciality" in a market driven system and should be reflected in the defunction uncorporated in legislation. Otherwise, the bill will be too norrowly down to achieve the stated objectives. Thank you.

Senator DANFORTH. Gentlemen, thank you very much.

[The prepared written statement of Mr. Verrill follows:]

August 6, 1986

BEFORE THE SENATE FINANCE COMMITTEE
TESTIMONY OF CHARLES OWEN VERRILL, JR.*

STATE TRADING IS AN INCREASING THREAT TO AMERICAN BUSINESS

Mr. Chairman and Members of the Committee

I am pleased to appear this morning to comment on S.2660, the "Anti-Mercantilist Trade Act of 1986," which is designed to cope with the growing phenomena of trading by state enterprises in disregard of the commerciality standard of GATT Article XVII. S.2660 is a welcome legislative initiative.

This Administration has repeatedly stressed as a fundamental goal of trade policy the achievement and maintenance of an open and fair world trading system. However, neither the fair trade laws, the reduction of tariffs, nor the dismantling of non-tariff barriers can accomplish this objective so long as enterprises owned or controlled by governments -- or enjoying special official privilege or favor -- buy and sell in world trade on terms inconsistent with commercial considerations. While GATT Article XVII requires such enterprises to sell and buy in accordance with this commercial standard, there is no accepted definition of "in accordance with commercial considerations." Nor has there been even token compliance with the Article XVII requirement that members "notify" other countries of the products exported by state trading enterprises.

By all accounts, state trading has grown significantly in recent years, particularly in commodities like steel and petroleum derivatives.[1] From the evidence available, it seems clear that much of this trade is not consistent with commercial considerations. Despite the lack of an official definition of this term, we suggest that trading inconsistent with commercial considerations occurs when the fundamental goal of enterprise management is to achieve state welfare objectives (e.g, employment, contribution to export goals, domestic consumer price maintenance, improved balance of payments, development of infant industry, etc.) rather than profit maximization and realization of return on investment. This definition recognizes that state enterprises are not per se inimical to world commerce; it is only when the state uses the enterprise for official goals that the Article XVII obligation is most urgently needed to avoid trade disruption.

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* Partner, Wiley, Rein & Fielding, 1776 K Street, N.W., Washington, D.C. This testimony is presented on behalf of Chaparral Steel Company and the Ad Hoc Committee of Domestic Nitrogen Producers to which I am special counsel on the state trading issue. As Adjunct Professor of International Trade Law and Regulation at Georgetown University Law Center, I have long urged implementation of GATT Article XVII.

[1] There is even an International Association of State Trading Organizations of Developing Countries ("ASTRO"). According to the ASTRO brochure, "there are today over 500 publicly owned organizations in developing countries engaged

(footnote continued)

It is, of course, axiomatic that commercial considerations are the primary means of economic regulation in the United States and many other countries. In such economies, overall state welfare is deemed best served by market driven capital and resource allocation. Production and pricing decisions are determined by supply and demand and the return on investment earned from prices set in the marketplace. Enterprises are not expected to ignore profits or sacrifice return on investment to maintain employment, achieve development goals or sell for export to enhance payments balances. Of course, even in the most capitalist countries, private enterprise is often encouraged to act consistent with state welfare goals through the use of subsidies that make up for any loss of profit or investment return that results from pursuing officially favored economic activities in lieu of profit maximizing lines of business. In these circumstances, the managers of a firm's capital do not sacrifice return on investment by directing business activities in ways that also achieve the goals of the government because the subsidy substitutes for the profit loss.

International trade law has long recognized that subsidies can have adverse effects when the products of the subsidized firm are traded on world markets. In such circumstances, countervailing duties to offset the value of the subsidy may be imposed in recipient countries. Since the adoption of GATT in 1948 and, more particularly, the Subsidies Code in 1979, export subsidies have been generally prohibited. While the Code acknowledges that domestic subsidies are a legitimate government policy instrument, such subsidies are explicitly countervailable where they have injurious effects in other countries.

(footnote continued from previous page)
in the field of foreign trade and import-export operations. These STOs . . . control a substantial percentage of world trade."

For a variety of reasons, state trading enterprises often operate outside these legal restraints. Unlike private, profit-motivated companies, state trading enterprises are often established and maintained to achieve welfare goals. With few exceptions, the management of these enterprises is required to be responsive to the political and social criteria established by the ministry in control; profitable prices and return on investment are of secondary importance. There are numerous examples:

(A) In Italy, the Istituto de la Reconstuzione d'Italia ("IRI") is a state-controlled holding company that, in turn, controls four of the largest banks in Italy, Finsider (the largest steel company), Alitalia, and numerous other chemical, transportation and miscellaneous companies. In a 1977 countervailing duty investigation, it was disclosed that the four banks controlled by IRI maintained a preferential rate of interest for state companies that was signifcantly lower than the rate charged to privately owned enterprises. Treasury determined, however, that the preferential rate was not a countervailable subsidy because the banks, while controlled by IRI, nevertheless were marginally profitable so that funding of the interest rate differential did not come from public funds.[2] In reaching this conclusion, Treasury dismissed as irrelevant the fact that the interest differential was maintained at the direction of the state planning agency responsible for public companies. [This decision was explicity overruled by the definition of domestic subsidy ("if provided or required by government action") adopted in Section 771(5)(B) of the 1979 Trade Agreements Act.]

(B) In Germany, Salzgitter A.G. is by most accounts the most inefficient steel producer. It shares are principally owned by the state of Saxony.[3] Salzgitter is an aggressive exporter of structural shapes to the United States where its prices are consistently among the lowest of any competeing imports. Chaparral which produces structurals at a highly efficient, world class facility in Midlothian, Texas, has call reports that consistently identify Salzgitter among the price leaders in sales to the U.S. market. Because of the emphasis on full production, companies like Salzgitter are usually determined to fill entitlements under the Bilateral Steel Arrangement with the European Community at any cost or at whatever price is necessary to make the sale. While suffering heavy losses, Salzgitter is able to continue in operation by a variety of state aids that are principally designed to maintain employment: however, Salzgitter is effectively shielded from countervailing duties by the President's Steel Program.

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[2] Grain Oriented Silicon Electrical Steel from Italy, 42 Fed. Reg. 54899 (1977).

[3] Certain Steel Products from the Federal Republic of Germany, 47 FR 39,345 (1982).

(C) Interbras, the trading arm of Petrobras (the Brazilian owned state conglomerate) was recently found by the Commerce Department to be exporting ethanol to the United States at prices below acquisition cost.

(D) In Venezuela, SIDOR is the state-owned steel enterprise. SIDOR reportedly has the unique advantage of participation in the administration of the program that allocates import licenses for steel products.[4] As a consequence, import licenses are granted based on domestic steel production. When there is local availability of steel, no imports are permitted. Only when there is a shortage in the domestic market are licenses issued for imported products. While obviously a trade barrier, these restrictive practices are difficult to address under the traditional trade laws.

(E) In Saudi Arabia, because of the ostensible reliance on the religious law ("Sharia") forbidding interest, Saudi enterprises are provided capital from state lending agencies either at no interest or at very low service charges.[5] Typically, these loans are for a long period of time, and since there is little or no "interest," give Saudi enterprises a significant advantage in competing in world markets. Oil revenues have also financed the construction by Royal Commissions of large gas distribution systems, infrastructure in industrial cities and extensive transportation facilities. The Commerce Department does not regard these interventions as subsidies because the loans and infrastructure are not limited to a specific group of enterprises.

As these examples demonstrate, state ownership or control of enterprises engaging in what are usually regarded as commercial activites has the potential of disrupting trade in ways that are not remediable by application of the traditional trade remedies. Frequently, this is because the advantages accruing from state ownership or control are not quantifiable like a specific subsidy to a private enterprise. Instead, the advantages have a more transcendental character but nevertheless have a specific impact on trade as demonstrated by Professors R. Joseph Monsen and Kenneth D. Walters, School of Business Administration, University of Washington, in their recent study, Nationalized Companies: A

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[4] See National Report on National Trade Estimates, 1985, Office of the United States Trade Representative, at 216.

[5] Carbon Steel Wire Rod from Saudi Arabia, 51 Fed. Reg. 4,206 (1986).

Threat to American Business.[6] Among the advantages of state enterprise that provide a commercial edge and which are cited by Monsen and Walters are the following:

(A) No Need to Earn Profits: "The biggest advantage for state-owned companies is their ability to succeed, and even thrive, without earning profits." Monsen & Walters at 106. Since the primary objectives of state enterprises are often goals inconsistent with profits, the inability of such enterprises to cover expenses plus a return on assets invested is not considered a management failure if the welfare goals are met. At the same time, taking the profit factor out of pricing obviously permits state enterprises to compete on world markets and expand market share particularly against competitors that must survive by the capitalist rules of the marketplace.

(B) Access to State Financing: Monsen and Walters emphasize that "state owned companies enjoy ready access to the state purse" and that "when private banks provide loans to state companies, the Government usually guarantees repayment, insuring a low interest rate." Monsen & Walters at 106-109. It is quite common for states to guarantee the obligations of controlled enterprises which usually results in a lower rate of interest, reflective of the official guarantee, than could be obtained by a private firm. This interest advantage is not countervailable. Neither is the guarantee unless it is customary in that country for companies to charge their subsidiaries a guarantee fee (it usually is not).[7]

(C) Built-In Markets: State enterprises according to Monsen and Walters, benefit from "direct government influence in procurement decisions . . . ." Monsen & Walters at 109. And, they conclude, a "large, state-owned sector enormously expands the scope of public procurement, and thereby multiplies the protectionist forces in the entire economy." Id. at 111.

(D) Monopoly Power: Monsen and Walters argue that state monopolies, such as airlines, tobacco and alcohol, are "often explicitly chartered to pursue a range of objectives other than profit." Monsen & Walters at 111. These goals include "acquiring foreign exchange, aiding national defense, encouraging tourism, and maintaining employment." Id. State monopolies -- such as SIDOR -- that buy and sell in competitive world markets "and is the sole seller in an inelastic domestic market can generally return substantial profits to the state treasury." Id. at 112. Moreover, such enterprises have substantial incentives to "unload" any surplus production on world markets to ensure full capacity utilization.

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[6] McGraw-Hill Book Company, 1983. Hereinafter cited "Monsen & Walters."

[7] Carbon Steel Wire Rod from Trinidad and Tobago, 49 Fed. Reg. 480 (1984).

(E) Operating Without Fear of Bankruptcy: Monsen and Walters conclude that "state ownership usually confers immortality on an enterprise. Governments rarely allow their companies to go bankrupt regardless of how staggering their losses may be. In fact, large losses are as likely to be followed by massive new injections of investment funds as by cutbacks in production, as the Italian state-owned enterprises have shown." Monsen & Walters at 112-113.

(F) Hidden Subsidies: Here again, Monsen and Walters conclude that "subsidies to corporations are more easily disguised than are tarrifs or quotas. It is nearly impossible to unravel the tangled financial relations between Governments and state enterprises." Monsen & Walters at 114.

These considerations are an excellent reason why S.2660, the proposed state trading legislation now before the Committee, should be included (with modifications) in the Senate Trade Bill or passed independently. S.2660 would complement GATT Article XVII which imposes a clear and specific commercial obligation on all contracting parties:

> Each contracting party undertakes that if it establishes or maintains a State enterprise, wherever located, or grants to any enterprise formally or in effect, exclusive or special privileges, such enterprise shall, in its purchases or sales involving imports or exports . . . (b) . . . make any such purchases or sales solely in accordance with commercial considerations, including price, quality, availability, marketability, transportation and other conditions of purchase or sale . . . .

Any contracting party maintaining such enterprises is required to notify all other GATT members of the products exported or imported. The framers of GATT intended Article XVII to apply to every type of economy.[8]

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[8] Article XVII was intended by the framers of GATT to apply to both market economies and nonmarket economies. This is clear from the documentary evidence available concerning the evolution of Article XVII. For example:

(footnote continued)

GATT Article XVII applies to three categories of enterprise: (1) agencies or instrumentalities of a state such as a ministry charged with sale and distribution of natural resources; (ii) organizations that are controlled and maintained by the state such as state-owned corporations of which British Steel Corp., Petrobras Comercio International S.A. (Brazil), USINOR (France) and the Philippine International Trading Corp., are well known examples; and (iii) private organizations without government ownership that receive "special privilege or favor" from the government. Section 4(B) of S.2660 should be amended to reflect these three categories. As the definition now stands, state owned or maintained enterprises [category (ii) listed above] would have to benefit from special privilege to be subject to the provisions of the bill. This is too restrictive: it would, for example, exclude British Steel which is clearly subject to Article XVII. The "special favor or privilege" qualification in Article XVII is intended to embrace wholly private enterprise within the commerciality obligation if the government has extended favor or privilege to a business organization without any government ownership or control and S.2660 should adopt the same criteria.

Despite the clarity of the general rules defining state enterprises and the application of the commerciality obligation to all economic systems, the GATT negotiators who drafted this Article were unable to specify what was meant by the requirement that "commercial considerations" govern the conduct of state trading operations. At the time, it was anticipated that the consideration of concrete cases by GATT members would eventually result in the development of substantive guidelines. "It must be recognized that state trading is a relatively new phenomenon, and thus the estab-

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(footnote continued from previous page)

> The problem of relations between nations which conduct their trade wholly or in part by means of state trading enterprises and those which conduct their trade through private channels is of immediate and significant concern to countries in both these categories. The purpose of the provisions on state trading is to establish principles parallel to provisions governing private trade so that the structure of the Charter obligations and principles cannot be nullified by the activity of state trading enterprises.

Preliminary Analysis of the Geneva Draft Charter for an International Trade Organization (1947) at 88.

lishment of rules of conduct and of a forum for discussion may make possible the development of something approaching case law on the application of commercial principles to state trading."[9] This has not proved to be the case.

At the first full session of GATT in 1958, there was general concern over the increase in state trading activities in a number of countries[10] and a panel was appointed to examine the phenomenon in greater detail.[11] This panel met in 1959, 1960 and again in 1962 to review Article XVII and the problems presented by state trading. As noted by one GATT observer, "it was realized that with fully state-trading economies participating in the work of GATT, the importance of precise and close supervision of the existing rules would become of overall importance."[12] Although the panel made no changes in the text of the Article, it clarified the definition of state trading enterprises, improved notification procedures, and obtained assurances that a thorough investigation of state trading activities would be conducted every three years.[13]

Despite these preliminary efforts, the GATT has still not come to terms with the meaning of commercial considerations. Nothing approaching "case law" has evolved that would give guidance on the application of commercial principles to state trading. Recognizing that state trading is a major trade issue, the United States has now given notice that the next GATT round should include consideration of a code to implement Article XVII:

> Government trading entities, or trading entities which are government owned or controlled, can introduce serious distortions in the international marketplace. In view of the increasing, rather than decreasing, prominence of state trading enterprises in international

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[9] Office of Public Affairs, U.S. Department of State, Informal Commentary to accompany Preliinary Draft of Articles of a Charter for an International Trade Organization of the United Nations. (Feb. 1947).

[10] G. Curzon, Multilateral Commercial Diplomacy: The General Agreement on Tariffs and Trade and Its Impact on National Commercial Policies and Techniques 293 (1965).

[11] Id.

[12] Id. at 293-294.

[13] Id. at 294.

> trade, we believe the negotiations should aim to make these rules operational and enforceable with respect to trade by government enterprises of all GATT members.[14]

However, such a resolution -- if it occurs -- is years away. Therefore, it is appropriate for this Committee to consider implementing legislation at this time.

The proposed legislation would enlarge the definition of unjustifiable in Section 301 to include state trading on terms not in accordance with commercial considerations and would create a new "mercantilist practice" right of action modeled after Section 337 of the Tariff Act of 1930. In both instances, the essence of the remedy is the test of commerciality which is based on a comparison of state enterprise prices with "similar arm's length commercial purchases or sales" or in the absence of such sales, the constructed value of the product sold as defined by the antidumping law. Where actual sales are at prices below this "normal" value, and the other criteria are met, action against the state enterprises would be authorized under either of Sections 301 or the new remedy proposed in Section 6 of S.2660.

Inasmuch as GATT Article XVII already imposes the commerciality obligation on member countries that maintain state enterprises, the proposed amendments to Section 301 would make explicit the right of the United States to enforce the Article XVII obligations. (As to countries that are not countracting parties, the GATT principle of commerciality is a legitimate test of trading conduct.) Under Article XVII, the United States has a right to expect that goods imported from state enterprises are sold in this market in accordance with commercial considerations, and that state enterprise goods traded in third countries and the country of origin conform to the commerciality standard. And, the United States is entitled to notification of state enterprise trade. These are benefits accruing to the United States which it is appropriate to enforce under Section 301.

While it is clear that Article XVII imposes a commercial obligation on states that control or maintain trading enterprises, the GATT precedents provide no guidance on the scope or nature of the commitment to conduct state trading "in accordance with commercial considerations." The Section 301 amendments in S.2660 propose a definition of commercial considerations based on a comparison to actual selling prices or constructed value.

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[14] U.S. Objectives in The New Round of Multilateral Trade Negotiations, Testimony of Ambassador Clayton K. Yeutter, U.S. Trade Representative, Senate Finance Committee, May 16, 1986, at 9.

In our view, however, while below normal value pricing is an important litmus of commerciality, the replication of the antidumping test as the sole criteria for commerciality will not be sufficient to deal with the myriad of competitive advantages realized by state enterprises. Moreover, no administration is likely to exercise the discretionary authority in Section 301 to address below normal value pricing that is not influenced by state action, even if the enterprise itself is state owned, because there is already a dumping remedy. For example, if a state-owned enterprise is entirely independent of state control, so that management decisions are taken solely for profit maximizing or loss reduction purposes, would it not be better to deal with any pricing disparities through the antidumping law?

Conversely, because of the scope and variety of state enterprise advantages, existing remedies are often wholly inadequate. For example, if a state-owned enterprise has -- because of its large scale production -- depressed prices world wide and has low costs of production because the state furnishes an essential raw material (natural gas, coking coal, etc.) free of charge (or at a very reduced rate), then it is entirely possible that the normal value criteria would not be breached. Yet, this is the very type of state enterprise conduct that can do the most damage to world trade and American companies.

For these reasons, we recommend that the term "commercial considerations" be redefined -- at least, for purposes of Section 301 investigations -- to include the following concepts:

(i) Does the state enterprise sell its products in world trade at prices below the level of prices charged by market economy companies independent of state control or below the constructed value of the product, taking into account the value of subsidies?

(ii) Even if the state enterprise cannot be determined to have sold a product below its normal value (where, for example, overproduction has driven all prices down), is there evidence that the enterprise has adversely affected world or regional prices -- particularly in commodities -- by excessive production that is not justified by relevant demand giving due regard to the share of trade in a previous representative period and any special factors, including any induced or influenced by state enterprise trading, that may be affecting trade in such product?

(iii) Is there evidence that the state enterprise has expanded market share in the United States or third countries following new capacity additions (investment) that are not justified taking into account reasonable rates of return and the development status of the state maintaining the enterprise as provided in GATT Article XVIII?

(iv) Is there evidence that the state enterprise does not generate revenues, over a reasonable period, sufficient to cover all costs or that would -- if the enterprise were privately owned -- be adequate to attract financing in the capital markets?

(v) If any of the foregoing determinations are affirmative, a finding of commercial inconsistency shall be authorized unless the enterprise can demonstrate that it is operated wholly independent of state control save normal regulation applicable to private enterprises in developed market economies.[15]

This broader definition would provide the USTR with greater flexibility in dealing with state trading and if coupled with mandatory initiation would be an effective remedy. It does seem appropriate to further amend Section 301 to specifically authorize the President to utilize the full array of Section 201 remedies in addition to such other action as may be in his power. This flexibility is important because of the probable need to address price effects through tariffs in appropriate cases.

We are less enthusiastic about the alternative remedy in Section 6 of S.2660 which basically adopts the Section 337 procedure. As drafted, this would be a lengthy and expensive administrative litigation that would be always subject, in the end, to the discretion of the President, which is precisely what Section 301 involves. Because of this discretion, and for a variety of other mostly related reasons, the domestic petitioner would have little incentive to utilize the alternative remedy proposed in Section 6.

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[15] In this connection Monsen and Walters point out that in 1969 "Sweden set up a holding company, Statsforetag, to serve as a buffer between government and the management of state companies. Government ministers, politicians and civil servants were told not to interfere with individual state companies . . . . In fact, the Swedes even have tried to establish the rule that any time the state asks a state company to perform a noncommercial duty, it must compensate the company for the cost of the additional responsibility." Monsen & Walters at 72.

In the first place, a normal dumping action would essentially make the same price comparison, would have a less restrictive injury standard, would provide relief quicker, and would not be subject to Presidential discretion. Secondly, the ITC is not experienced in making normal value comparisons and lacks the institutional expertise of the Department of Commerce. Finally, the remedy proposed in Section 6 of S.2660 is likely to be viewed as a dumping action in mufti and, therefore, would be arguably inconsistent with Article 16 of the International Antidumping Code.

Antidumping duties are authorized under Article VI of GATT. In the absence of Article VI, antidumping duties would usually violate both the most-favored-nation obligation of GATT Article I and the tariff concessions negotiated pursuant to GATT Article II. Thus, in essence, Article VI is an "'exception' to GATT" that is "carefully circumscribed." J. Jackson, World Trade and the Law of GATT 411 (1969) [hereinafter, "Jackson"]. The 1948 GATT Working Party confirmed that "measures other than compensatory anti-dumping duties may not be applied to counteract dumping except insofar as such other measures are permitted under other provisions of the General Agreement." See Jackson, at 406. (Emphasis added.) As Professor Jackson has stated, "despite attempts in the preparatory work to provide for other types of countermeasures to dumping, Article VI was intentionally limited only to antidumping duties. The limitation on the response allowed to dumping necessarily prevents punitive measures." Id. at 421. (Emphasis added.)

Article VI was interpreted in the 1979 Antidumping Code, which amplifies the limitations imposed by the Article and "govern[s] the application of Article VI of the General Agreement insofar as action is taken under anti-dumping legislation or regulations." 1979 Antidumping Code, Article 1. As Article 16 of the Code makes clear, "[n]o specific actions against dumping of exports from another Party can be taken except in accordance with the provision of the General Agreement, as interpreted by this Agreement."

The remedy proposed by Section 6 of S.2660, as drafted, would provide a remedy for sales below a commercial benchmark which is essentially the same as the less than fair value calculation under the antidumping law. Therefore, the proposed remedy is arguably outside the antidumping duties authorized by Article VI as interpreted by the Code. We recognize that the Section 6 remedy could be justified by a footnote in the Code which states that Article 16 "is not intended to preclude action under other relevant provisions of the General Agreement, as appropriate." Conceivably, it could be argued that Article XVII is an "other relevant provision" of the GATT which justifies action outside the Antidumping Code parameters.

Even if the proposed Section 6 remedy for state trading were justified by the footnote to Article 16 of the Antidumping Code, the "action" in such proceedings would still be at the Presidential review stage. This is inevitable because state trading involves GATT obligations and, potentially, compensation demands that may affect other industries or sectors in the United States. For this reason, state trading actions under Section 6 would be scrutinized far more carefully than the typical Section 337 action involving a patent or copyright. President Carter's rejection of the Commission's effort to expand Section 337 to predatory pricing, and the reasons for rejecting that initiative, illustrate this point.[16] For these reasons, it would be impractical to devote significant litigation resources to proving a case under proposed Section 6 at the Commission when so much depends on the outcome of the Presidential review.

An alternative to the full-blown Section 337-type proceeding would be to authorize the President to request the ITC, in any investigation involving allegations of state trading, to investigate the costs of production of any state enterprise product pursuant to the procedures of Section 336 of the Tariff Act of 1930, as amended. 19 U.S.C. §1336. Minor changes would be required in Section 336 and with those changes, the ITC could perform a proper advisory role that would have no GATT infirmity and which would considerably reduce the litigation expense typically involved in a Section 337 action.

Similarly, the Department of Commerce could be authorized to investigate and advise the USTR concerning normal values for products which could be derived from numerous sources. This is a common undertaking for Commerce (but not the ITC) that would not necessarilly be subject to rigid verification requirements.

These suggested modifications of the procedures in the draft bill would take into account the reality that, in the end, the USTR and the President would take the final decision in cases under proposed Section 6 based on factors that may be extraneous to the Commission's responsibilities. In the consideration of commerciality and the obligations of GATT-member states toward state enterprises, we believe the major focus should be at the USTR level from the beginning rather than compressing these deliberations in the brief interval after an ITC recommendation.

Thank you.

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[16] Certain Welded Stainless Steel Pipe and Tube from Japan, Inves. No. 337-TA-29, 43 Fed. Reg., 17789 (Apr. 26, 1978).

Senator **Danforth**. What countries do you consider to be the leading users of State trading? Who are the main problems?

Mr. **Verrill**. If I might answer that, we see that problem occurring from the standpoint of our clients in all sorts of economies. For the steel industry, for example, the State trading issue is one that comes up all the time in the context of European countries. In my statement, I give an example about a German company called Salzgitter. State trading occurs in a number of developed countries that are outside of Europe. And finally, there is an extensive State trading network in the so-called lesser developed countries. In fact, there is an organization known as ASTRO which claims to represent something like 500 State trading enterprises in developing countries and has been organized in order to advance their interests. Indeed, ASTRO claims to represent a very significant percentage of world trade.

Mr. **Millian**. In our comment beginning on page 14, we list a series of examples, certainly starting with the Soviet Union, then going to Brazil, Saudi Arabia, Mexico, and we end up with a methanol plant in Indonesia. These are examples of decisions by governments to build plants for noncommercial reasons.

Senator **Danforth**. Do you believe that we should deal with market and nonmarket countries differently?

Mr. **Millian**. Certainly, they should be dealt with under the same ground rules. Today, unfortunately, the way our laws are written, it seems that we can take dumping cases with some effect against our allies in the Western World, but with no real assurance that we are going to get anywhere if we go against a nonmarket economy.

I think I circulated a letter to you indicating that our industry has filed dumping cases this year, on July 16, against the Soviet Union, East Germany, and Romania. The chance of finding a solution given the loops we have to go through, is not necessarily that high. If it were against a Western economy, it would be a heck of a lot easier.

Senator **Danforth**. Senator Bentsen.

Senator **Bentsen**. This issue of State trading looks like we are uncovering a huge infrastructure of trade that we haven't really addressed in this committe before. I am trying to get a feel for how extensive it is. I listened to Dr. Hathaway and what he said on wheat. Mr. Millian, would you give me those numbers again—the progression? Shock me a little.

Mr. **Millian**. We are talking just urea, Senator. In 1981, imports from nonmarket economies into the United States accounted for 2 percent of the U.S. imports.

Senator **Bentsen**. Yes.

Mr. **Millian**. Last year, we estimate they were between 25 and 30 percent of U.S. imports; and today they are between—this year, 1986—we estimate between 40 and 45 percent.

Senator **Bentsen**. And that is from State trading——

Mr. **Millian**. From nonmarket economies.

Senator **Bentsen**. Nonmarket economies.

Mr. **Millian**. There are plenty of other State trading companies, but I am talking only about nonmarket economies—that niche.

Senator **Bentsen**. Are we running into that kind of a pattern—I am sure you cited me one of your extreme cases to make your point—but are we running into a substantial increase in that kind of a state-owned and directed market export? Is there a substantial increase taking place in it or not?

Mr. **Millian**. Today——

Senator **Bentsen**. Apart from urea.

Mr. **Millian**. Take ammonia, per se; urea and ammonia, as you know, are connected. I think in 1980, 43 percent of all production was in government hands. Today, 70 percent is, and they are continuing to build plants. So, in 1990, if we built no more plants, demand would just reach our current worldwide production; but we know that the Soviet Union is going to build 14 more plants, or whatever the number is. So, obviously, they are not making these decisions for commercial reasons. Here again, in the case of urea, the U.S. industry is losing $20 a ton of cash cost—below cash cost. So, unless you are a big company like W.R. Grace and maybe make a little money somewhere else, you are literally going to go out of business.

Senator **Bentsen**. Mr. Verrill, do you have a comment on that?

Mr. **Verrill**. Yes, I was going to add, Senator Bentsen, that in the steel industry much of the new investment outside the United States has been by companies that are significantly or entirely State owned and controlled, and many of those companies are now beginning—if they haven't already done so—to be significant factors in the U.S. market.

Saudi Arabia, for example, has a new 800,000 ton capacity steel mill.

Senator **Bentsen**. Owned by the government itself?

Mr. **Verrill**. Yes; either by the government or a enterprise controlled by the government. Another example is Trinidad in Tobago which has developed a very substantial State-owned steel industry primarily for the export markets. There is a huge State-owned mill in Indonesia which is considered to be the most inefficient steel mill in the world, by accounts that I have read.

Senator **Bentsen**. That takes the place of the one in Mexico?

Mr. **Verrill**. It is probably a close call, but the relative inefficiency is so high, it is hard to make a comparison and decide which is most inefficient.

These examples are not unique to steel: I think comparable examples exist, its in a number of other industries as well. In fact, there is an excellent book written by two professors at the University of Washington called "Nationalized Companies, A Threat to American Business," which I have referenced in my prepared statement, and which goes into considerable detail and analysis of the growth of nationalized companies in Europe, in particular, and demonstrates how State-control and all of the ancillary impacts have had significant influence on trade.

The authors of this book came up with what I think is one of the great lines about nationalized companies; that is that "nationality confers immortality on enterprise," because they are no longer subject to the rigors of bankruptcy and so forth that a private company is.

Mr. **Millian**. You might be interested in some more figures——

Senator BENTSEN. The countries are facing bankruptcy, but not the companies. [Laughter.]

Mr. MILLIAN. By 1990, we estimate that 92 percent of projected capacity in the fertilizer area will be government owned or controlled. The numbers show that the governments own almost 90 percent of the world's oil reserves and a like amount of natural gas reserves. Their ownership has gone downstream, as we all know, in the feedstock and fuel areas. And then, there is the area of phosphate fertilizers and potash, in which the numbers are going up.

Senator BENTSEN. It looks like we have a 900-pound gorilla to grapple with. It is not going to be easy.

Tell me: Why would a less developed country go so much to State-owned enterprises rather than using at least the veneer that Japan uses where its government influences marketing through the private sector?

Mr. MILLIAN. In my first career—25 years in the foreign service—I had an opportunity to live in countries, not in the bloc, but like Argentina for example, where 50 percent of the defense industry is owned by the military.

Senator BENTSEN. Owned by whom?

Mr. MILLIAN. The military, by the Government of Argentina. It gives them an opportunity for employment. It is a big political factor; and it gives a tremendous whammy to the military in a political sense when they start to move around within the political structure. There has been a history of nationalization throughout the developing world for a variety of reasons. I think some countries now understand—belatedly, and it is difficult to change—that this is not necessarily working. I think businessmen realize that you are dealing with a totally different animal. The government wants this industry to stay in place; it is going to provide ways to do that. If it makes money, for example, like Pemex, we think, did in the sale of crude oil, it is going to then subsidize the fertilizer industry. I mean, that is just the way life is, when you start down the track of having State enterprises as the major form of doing business in a country.

Senator BENTSEN. Thank you, Mr. Chairman.

Senator DANFORTH. Senator Baucus.

Senator BAUCUS. I was wondering what the trend will be in the future. That is, Mr. Millian, did you say that some countries are beginning to wake up?

Mr. MILLIAN. France, for example.

Senator BAUCUS. Is there any way to determine whether the trend will be toward more State trading companies or toward less, just generally? I mean, what is the drift? What is the trend?

Mr. MILLIAN. Your bill, with the proper teeth in it, saying you can't come into the world marketplace because article 17 says you have to act like a business—if that really is applied—I think you will see a lot of changes. They won't be building as many new plants.

Senator BAUCUS. Dr. Hathaway, you say that 90 percent of world wheat imports are handled by State trading or government authorized boards. As a practical matter, what effect does that have on the American farmer, the American wheat producer?

Dr. HATHAWAY. Well, I think the simple way to answer is that if those same controls were operated in the form of quotas, I would think that the American farmer would be screaming about market access and have a very real concern about it. Those import controls mean that there is no control over internal resale prices. They can charge whatever internal price they want. They can essentially control who the users are. It has all the effects that import quotas have plus some more; and therefore, it has an adverse effect upon the ability of lower prices to be transmitted to the consumer and to have the consumers elsewhere benefit. And that is one of the things that trade is supposed to be about.

They purchase on the basis of who they want to purchase from. Now, that doesn't always work against us. I think we should recognize that. The Japanese food agency, year in and year out, buys 60 percent of its wheat from the United States. The rest of the world buys perhaps 30 percent of its wheat from the United States. State trading doesn't always work to our disadvantage; but it basically has the same effect in many ways as the GATT-illegal import controls that we claim we are going to get rid of.

Senator BAUCUS. Could you quantify the adverse effect on the American farmers, just roughly? Would American wheat prices be higher if this practice were discontinued?

Dr. HATHAWAY. It is very hard to quantify this because you have to go country by country and look at the other side of the equation; and that is: What do the selling agencies and State trading agencies, the impact that they have on the selling side of the market? I think the answer is: If there were more liberal trade in grains, yes, American farmers would have higher prices for their grains.

This is one of a wide series of policies which basically inhibit trade and encourage production in the wrong places, et cetera.

Senator BAUCUS. You mentioned that, because this is a multilateral problem, we cannot pose unilateral solutions. How long can we wait? It seems to me that, if there is a new GATT round—the general conclusion is that one is some time off, 5 or 10 years—and that assumes that a successful resolution to this particular problem, as well as others that bear on the price that wheat producers do or do not get—I mean, how long can we wait? Would some unilateral action perhaps of some kind in the meantime be necessary?

Dr. HATHAWAY. I think the question perhaps, Senator, is a different one, and that is: Given the fact that this is not a high priority item on the agenda of agricultural groups which are interested in trade negotiations, why are they overlooking this issue? I have never understood that, and I still don't understand it.

Senator BAUCUS. Why do you suppose they overlook it? What is your best guess?

Dr. HATHAWAY. I have never been able to understand it. Yesterday, I testified before the Senate Subcommittee on Trade of the Senate Agricultural Committee. I was interested to note that this whole set of issues was not even on the agenda that was discussed for the GATT round in agriculture.

Senator BAUCUS. Is it ignorance?

Dr. HATHAWAY. No.

Senator BAUCUS. Too complex?

Dr. HATHAWAY. I don't know the answer to the question. I have always been fascinated why American free enterprise actually likes to sell so much to State trading organizations. Perhaps it is because it is easier business than it is to do it elsewhere; but I have never heard complaints on this issue, and I think it is a major problem. It is a problem that the President's Export Commission tried to address but it was not terribly successfull.

Mr. MILLIAN. I think there is an awakening on the part of the farm organizations. We have as part of our coalition, and joining us in the dumping suit, both Farmland and CF Industries, which are farm cooperatives in the fertilizer business; also the National Council of Farmer Cooperatives decided—I think about 6 months ago—to join our whole effort in the natural resource subsidy—State trading area. The problem that I would just like to underline is that your bill only goes part of the way. It talks about price; and whatever the commodity is, if over capacity is built by a foreign State trading organization, it will bring into the total marketplace more than we need. Again, in the case of fertilizers, this will bring prices down; once that occurs, we either lose money or go out of business eventually.

So, in effect, they are taking over the marketplace, and there is no way to recover from that. That is the real issue here. Now, unless you look at the cost of production and you look at the investment factor in addition to price, you are dealing with a market price that is already depressed, particularly in the commodity market.

Senator BAUCUS. All right. Thank you.

Senator DANFORTH. Senator Bentsen.

Senator BENTSEN. I think we are uncovering an enormous infrastructure of trade that hasn't been pressed; and when you state that some of these groups have not focused in on it, that is what we are trying to do with these hearings—draw attention to what is an incredibly difficult problem for us and what the private sector is facing in the way of competition from State-owned companies and industries.

Do you think that the countervailing duty law is adequate to beat this kind of a problem?

Mr. MILLIAN. We do, but the Department of Commerce does not. We feel that the countervailing duty law could be used against nonmarket economies, and I think there now is a Court of International Trade ruling which confirms this; but still, I think the Department of Commerce is going to fight that decision. This would make life a little easier in the nonmarket economy area in particular.

Senator BENTSEN. One of the things we are trying to do, of course, is to get quite explicit on the utilization of 301.

Mr. MILLIAN. Right.

Senator BENTSEN. That the authority is there and that it should be used for that purpose so those in the private sector will bring their allegations in that regard. Let me ask you one more question—any one of you.

Is price distortion the only distortion that we see in this kind of an approach to the market?

Mr. VERRILL. I would say not, Senator Bentsen. Price distortion is certainly one of the factors that one encounters in dealing with State trading enterprises; and indeed, there are of course instances where you can deal with State trading enterprises under the existing antidumping or countervailing duty laws. We, in fact, did win a case against Saudi Arabia as to some of the effects of State trading relative to the enterprise producing steel; but a lot of the other factors that influence that company's operations we couldn't reach under the countervailing duty law. As regards the nonmarket economies, as Mr. Millian pointed out, the Commerce Department has chosen not to apply the countervailing duty law to nonmarket economies.

That case was appealed to the Court of International Trade, where the court said it should be applied; and now, we are awaiting a decision from the court of appeals from the Federal circuit as a result of the Commerce Department's appeal from the intermediate court's decision. The fact is that there are a number of things and factors that influence trade in the context of a State trading enterprise that you can't directly address under the countervailing duty and antidumping laws.

In part, that is due to the fact that the laws are sometimes written very narrowly. It is true, for example, with respect to the so-called generally available test for subsidies. That precludes the application of the countervailing duty law to a lot of State trading activities that do have distortion effects in world trade; and we think those are the things that this bill could deal with very effectively.

Senator BENTSEN. Mr. Chairman, I have a hunch we are going to hear a lot more about this subject as time goes on. I appreciate very much your holding these hearings.

Senator DANFORTH. Thank you, Senator Bentsen, and thank you, gentlemen.

[Whereupon, at 10:58 a.m., the hearing was adjourned.]

[By direction of the chairman the following communications were made a part of the hearing record:]

BEFORE THE SENATE FINANCE COMMITTEE
SUBCOMMITTEE ON INTERNATIONAL TRADE

STATEMENT OF
THE AMERICAN HARDBOARD ASSOCIATION
IN SUPPORT OF
S. 2660

Submitted by:

James E. Nolan
Executive Vice President
American Hardboard Association
520 North Hicks Road
Palatine, Illinois 60067
312-934-8800

William C. Ives
Brock R. Landry
Robin W. Grover
Keck, Mahin & Cate
1730 Pennsylvania Avenue, N.W.
Suite 350
Washington, D.C. 20006
(202) 347-7006

Date: August 20, 1986

The American Hardboard Association ("AHA"), the national trade association of nine American and one Canadian hardboard manufacturers (See attached membership list), submits these comments in support of S. 2660, a bill that would help privately-owned American companies combat the unfair trade advantages often enjoyed by trading enterprises owned, supported or favored by foreign governments.

AHA's member companies account for more than 90 percent of U.S. hardboard shipments. AHA has always been, and continues to be, on record in support of free and fair trade. A current example of this position is AHA's strong public support for the establishment of bilateral free trade between the United States and Canada in hardboard, first expressed to the Administration in 1983 and reiterated before the International Trade Commission ("ITC") in 1985. 1/ AHA believes in the elimination, rather than the erection of trade barriers between nations. However, AHA members are also extremely concerned about rising hardboard imports from countries with non-market economies and/or state-owned or supported trading enterprises.

Non-market or centrally-planned economies are not subject to the discipline of free-market mechanisms since they set prices, wages and material costs on an artificial basis rather than in response to the natural economic laws of supply

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1/ See ITC Investigation No. 332-196.

and demand. As a result, exports from non-market economies often are effectively "dumped" in free markets to the detriment of domestic manufacturers who operate under free market principles. It is generally conceded that U.S. antidumping and countervailing duty laws have been ineffective in halting unfairly-traded products from non-market economies. Similarly, exporters from "free market" countries often receive direct and indirect assistance from their respective governments, while competing products are effectively foreclosed from that country's market. Given governmental support, state-owned or assisted trading companies can enjoy a tremendous advantage over privately held companies in world markets. Moreover, a government having such ties to a particular firm will invariably favor that enterprise in the domestic market. A primary example of such a nation is Brazil, the leading exporter of hardboard to the United States. Hardboard imports from Brazil are currently subject to American tariffs in the range of 3.8 to 7.5 percent, 2/ while American hardboard exports are assessed a 160 percent *ad valorem* tariff by that nation. 3/

2/ Imports of hardboard are currently classified under T.S.U.S. Item Nos. 245.00, 245.10, 245.20 and 245.30.

3/ Brazil is not even issuing import licenses for hardboard at the present time.

While not eliminating such practices, S. 2660 would provide our industry with an effective method for obtaining relief. State trading enterprises which do not compete on the basis of commercial considerations such as product size, quality, marketability and availability could be subjected to American import restrictions, after investigation by the International Trade Commission and approval by the Administration. Moreover, by extending the scope of the President's authority under Section 301 of the Trade and Tariff Act of 1974 to cover the activities of state-owned or assisted trading companies, the bill would help domestic industries compete on a fair and equal footing for exports to third countries.

For the reasons stated above, the American Hardboard Association strongly supports the passage of S. 2660.

Respectfully submitted,

Jim Nolan

James E. Nolan
Executive Vice President
American Hardboard Association
520 North Hicks Road
Palatine, Illinois 60067
(312) 934-8800

Robin W. Grover
Brock R. Landry
Keck, Mahin & Cate
1730 Pennsylvania Avenue, NW
Washington, D.C. 20006
(202) 347-7006

August 20, 1986
19/015

AMERICAN HARDBOARD ASSOCIATION
MEMBERSHIP ROSTER

Abitibi-Price Corporation
3250 West Big Beaver Road
Troy, Michigan 48084

Evanite Hardboard, Inc.
1115 S.E. Crystal Lake Drive
Corvallis, Oregon 97339

Forest Fiber Products Company
P. O. Box 68
Forest Grove, Oregon 97116

Georgia-Pacific Corporation
1[illegible]3 Peachtree St., N.E.
Atlanta, Georgia 30303

MacMillan Bloedel, Limited
Building Materials Division
50 Oak Street
Weston, Ontario MN9 IS1

Masonite Corporation
29 North Wacker Drive
Chicago, Illinois 60606

Superwood Corporation
14th Avenue West and
Waterfront
Duluth, Minnesota 55802

Temple-Eastex, Inc.
P.O. Drawer N
Diboll, Texas 75941

U.S. Plywood Corporation
372 Danbury Road
Wilton, Connecticut 06897

Weyerhaeuser Company
P.O. Box 9
Klamath Falls, Oregon 97601

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Statement of

THE FERTILIZER INSTITUTE
on
S. 2660 The Anti-Mercantilism Act
of 1986

before the

Senate Finance Committee

August 20, 1986

The Fertilizer Institute
1015 18th Street, N.W., Washington, D. C. 20036
202-861-4900 Telex 89-2699

The Fertilizer Institute* appreciates the opportunity to submit this statement on S. 2660, the Anti-Mercantilism Trade Act of 1986.

The U.S. fertilizer industry is all too familiar with state trading. The U.S. phosphate industry is the only non-state private sector trading entity competing in world phosphate trade.

It is difficult for U.S. companies to compete with state-owned enterprises who forego market consideration to achieve political and financial goals. The difficulty is compounded when a U.S. government agency such as the Export-Import Bank (Eximbank) aids in financing government-owned and government-controlled export facilities that compete directly with U.S. products.

We therefore will focus on Eximbank assistance of state trading enterprises in our remaining statement because it has had a tremendous negative effect on the U.S. fertilizer export business.

The Fertilizer Institute opposes financial assistance from the Eximbank to expand phosphate production in government-owned, government-controlled countries in North Africa. This assistance, exceeding $200 million during 1979-85 to Morocco and Tunisia, has been extended by Eximbank despite the fact that the world phosphate industry in this period was, and still is, in a structurally overbuilt position. This assistance also has been extended despite facts showing that in this period U.S. phosphate capacities and production were losing much of their share of the world market to North African production.

Using data for 1984, loss of U.S. share in the world phosphate market represented a loss exceeding $200 million in foreign exchange. Also, with phosphate production cut back, there was an additional loss of domestic employment income in 1984 of $450 million. Thus, there was a total loss of approximately $650 million in the single year of 1984 to the U.S. resulting from the depressed world phosphate market, and loss of U.S. share in this market.

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*The Fertilizer Institute is the national association for the U.S. fertilizer industry. Its members (including producers, retailers, equipment suppliers and trading firms) account for 95 percent of the fertilizer produced domestically, and essentially all fertilizer exported.

Obviously, not all of this loss can be attributed to the $200-million assistance from the Eximbank to Morocco and Tunisia. However, a significant part of this loss can be directly attributed to this Eximbank assistance to two of the largest competitors with the U.S. industry in the world phosphate market.

BACKGROUND

Clearly, the objective of the Eximbank is to enhance U.S. exports by facilitating the financing of these exports. However, Congress has realized that such export enhancement programs can have both positive and negative effects on the U.S. economy. To ensure that the Eximbank's loan practices do not adversely affect U.S. industries, the bank's statutory authority states two conditions it will avoid.

- Serious adverse effects of loans or guarantees on the competitive position of the U.S. industry, including an evaluation of effects on employment and the competitive position of U.S. exporters.
- Funds for the Eximbank will not be used for loans for establishing or expanding production of any commodity for export by any country other than the U.S. if the commodity is likely to be in surplus on world markets, and if the assistance will cause substantial injury to U.S. producers of the same, similar, or competing commodity. (FY 1986 continuing resolution by the U.S. Congress)

Additionally, in 1978, Congress amended the Bank's charter so as to provide the following:

> The Bank shall implement such regulations and procedures as may be appropriate to ensure that full consideration is given to the extent to which any loan or financial guarantee is likely to have an adverse effect on industries, including agriculture, and employment in the United States either by reducing demand for goods produced in the United States or by increasing imports to the United States. To carry out the purpose of this subsection, the Bank shall request, and the U.S. International Trade Commission shall furnish, a report stressing the impact of the Bank's activities on industries and employments in the United States. Such reports shall include an assessment of previous loans or financial guarantees and shall provide recommendations concerning general areas which may adversely affect domestic industries, including agriculture, and employment.

In 1983, this provision was amended to authorize appropriations of funds to finance this study. To date, however, the Bank has not adopted any such regulations, explaining that it has not done so because funds have not been appropriated.

Evidence submitted in this statement will show that the Eximbank, by providing financial assistance to phosphate producers in North Africa, has deviated from two of its statutory guidelines:

- It has provided assistance to foreign producers of phosphates which in turn have increased production and exports resulting in economic injury to U.S. producers, and
- This assistance has been granted in the face of evidence that phosphates are in surplus on world markets.

Tables 1 and 2 summarize projects of the Eximbank since 1979 assistaing state trading enterprises in Moroccan and Tunisian phosphate operations. All of the projects have been approved by Eximbank to the detriment of the U.S. fertilizer industry.

Not shown in Table 1 is a $35-million operating facility for Morocco which the Bank did deny in 1984. The fertilizer industry objected strongly to this project in 1984, providing extensive evidence of the structurally over-built position of the world phosphate industry. Since about 1980, the U.S. phosphate industry has been in a structurally over-built position and no Eximbank assistance should have been provided to foreign producers of phosphates. This assistance has penalized the U.S. phosphate producers because North African phosphate producers (state trading enterprises) have steadily increased their share of the world phosphate market.

Table 3 shows phosphate rock production capacities during the past several decades. By 1986, U.S. production capacity increased 42 percent over 1970. However, compared with African capacities and African/Near East capacities, U.S. expansions have lagged far behind the large expansions in other regions. North African phospahte capacities in 1986 were several times greater than in 1970. Even with the international recognition of an over-built phosphate industry, expansions in Africa and the Near East are continuing unabated.

TABLE 3. Phosphate Rock Production Capacities

	U.S.	Morocco/ Tunisia	African/ Near East
		(Million Metric Tons)	
1970	40	16	27
1980	60	28	48
1986	57	42	72
Early 1990's		59	106
Percent increase, 1986 over 1970	42	162	166

SOURCE: National Fertilizer Development Center, TVA, January 1986.

TABLE 1

MOROCCO

Eximbank Assistance,
Fertilizer Industry,1980-1985

Date	CRNO Eximbank	Project	Type	Board Authorization ($ millions) Capital	Non-Capital	Total
Jan 80	06780	OCP - Mining Equip.	Direct Loan	$10.5		
Nov 80	06952	OCP - Construction Equip.	Direct Loan	17.5		
Mar 81	07048	OCP - Multi-project	Credit Loan		35.0	
Oct 81	07048	OCP - Mining Equip.	Sub-loan	3.6		
Mar 82	07177	Locomotives & Spare Parts	Direct Loan	13.0		
Jan 84	07328	Locomotives & Spare Parts	Loan Guarantee		0.7	
Jan 84	07327	Locomotives & Spare Parts	Direct Loan	5.4		
June 84	00020	OCP - Superphosphoric Acid Plant	Loan Guarantee		2.1	
Oct 84	00029	OCP - Blast Hole Drills	Loan Guarantee		4.8	
Nov 84	00042	OCP - Dragline	Loan Guarantee		2.1	
Dec 85	07431	OCP - Mining Equip.	Direct Loan	1.2		
	TOTAL 1980-1985			$51.2	$44.7	$95.9

SOURCE: Eximbank Printouts, January 1986

TABLE 2

TUNISIA

Eximbank Assistance,
Fertilizer Industry, 1980-1985

Date	CRNO Eximbank	Project	Type	Board Authorization ($ millions) Capital	Non-Capital	Total
Sept 79	06673	Gov't. of Tunisia - Multi-Projects	Line of Cretit	*	$100.0*	
Jan 81	06673	Phosphate Mining Equipment	Sub-loan	$ 3.2		
Sept 81	06673	Diesel Electric Locomotives	Sub-loan	20.0		
	TOTAL			$23.2	$100.0	$123.2

*general purpose

SOURCE: Eximbank Printouts, January 1986

In Table 4, phosphate rock capacities of various regions are expressed as percent of world market share. The table shows that the perentage for the U.S. has been declining significantly since 1970 while increasing sharply for capacities in Africa/Near East. Further plans of Africa and the Near East will lead to a market share exceeding 42 percent. Data in Table 3 and Table 4 vividly show the declining position of U.S. phosphate producers in the world market while, conversely, showing the ascending position of phosphate producers in North Africa and the Near East. The important points these tables make are that foreign phosphate producers are expanding capacities despite a structural over-supply in the world market, and that U.S. producers are being injured as a result of foreign expansions.

TABLE 4. Percent of World's Market Share of Various Regions' Phosphate Rock Capacities

	U.S.	Africa/Near East
	(% of World	Market Share)
1970	43	30-
1980	38	30+
1986	30	38

SOURCE: National Fertilizer Development Center, TVA, January 1986.

Processed products of phosphate rock also are important when evaluating the international phosphate picture. Increasingly, finished phosphates such as phosphoric acid and ammonium phosphates are becoming more important in international trade than phosphate rock. In this connection, it is notable that, while the U.S. phosphate industry continues to operate at abnormally low operating rates for these finished phosphate products, and while many of its finished phosphate plants are closed, plants for these same products in North Africa are expanding at an unabated pace.

In Africa and the Near East, wet processed phosphoric acid capacities increased from 1 million tons of P_2O_5 in 1970 to 3 million in 1980. By 1986, capacity for this product in this region doubled over 6 million tons of P_2O_5 per year, and plans have been announced for expanding this product capacity to over 9 million tons by the early 1990s. Again, as in the case of phosphate rock, the U.S. share for wet process phosphoric acid has dropped sharply in recent years. . .from 45 percent in 1970 to 32 percent in 1986, with a further indicated drop to 27 percent in the early 1990s. In contrast, capacities for this product in North Africa and the Near East will increase their share of international capacities from 7 percent in 1970 to 12 percent in 1980, and to 19 percent in 1986. Indicated increases by the early 1990s will give this region 22.5 percent of the world's capacity.

Penalties to the U.S. Industry

A significant point in comparing the U.S. phosphate industry with the African and Near East phosphate industries is that much of the U.S. phosphate production is for domestic consumption. Thus, domestic supplies of phosphates for agriculture depend greatly on the well-being of the domestic U.S. phosphate industry. Other major phosphate producers place very little of their production in their respective domestic markets. Instead, they look at the international market, and their increased exports in this commodity market directly displace tonnage from U.S. producers.

It is noteworthy that among its procedures identified in a memorandum of the Eximbank, January 5, 1979, regarding adverse domestic impact of Eximbank financing, there is the identification of transactions involving displacement in third market countries. For example, a plant built in North Africa for phosphates could sell its production in the European Community and compete with exports coming directly from the United States. This is precisely what has occurred as North Africa has expanded its phosphate production.

With the world phosphate industry in a structurally over-built position, U.S. capacities and production are losing much of their world market share. Much of this loss appears to be a direct result of increased production in North Africa, part of which has been built with the assistance of Eximbank financing. The U.S. fertilizer industry recognizes the sovereign right of North African countries, operating through governmentally owned and controlled production facilities, to expand their production of phosphates. However, the U.S. fertilizer industry does not think this expansion should be assisted with U.S. funds such as those provided by Eximbank.

In a world market for a commodity item, such as phosphate rock or finished phosphates, one producer's advantage is another producer's disadvantage. To compound these problems, the U.S. phosphate industry is one of the very few remaining private sector industries in the world with this commodity, and it competes with facilities wholly-owned by governments or as parts of centrally controlled economies, which are rapidly increasing their share of the world market. With such a commodity situation, what one producer increases, in effect, is largely a loss for another.

In a recent study conducted for The Fertilizer Institute on the world phosphate situation and effects of Eximbank programs, it has been estimated that between 1980-1984 the U.S. lost 3.2 percent of the total world market share of phosphate rock. Total market for this product in 1984 was 48.1 million metric tons, thus the loss of 3.2 percent represented 1.5 million tons of phosphate rock exports. At a value of $28 per ton, this loss represented $43 million in foreign exchange earnings in 1984.

With similar comparisons for finished phosphate products, estimates are that the U.S. lost 4 percent of its share of the international market. In 1984, with total exports of 10.9 million tons of finished phosphates expressed as P_2O_5, the U.S. lost exports of over 0.4 million tons of P_2O_5. At an estimated value of $370 per ton P_2O_5, this loss in foreign exchange in 1984 was equivalent to $160 million. Thus, for the two products, the total loss in exports in 1984 alone was more than $200 million in foreign exchange earnings.

In terms of number of employees, the Institute study shows that in 1980 the phosphate rock mining industry had 14,620 employees. By 1984, this had decreased to 12,500, a loss of 2,120. In the industry for processing finished phosphates from this raw material, employment in 1980 was 15,600, but decreased in 1984 to 13,200, with a loss of 2,400 employees. Thus, the U.S. phosphate industry lost 4,520 employees in the four-year period while the Eximbank was assisting North African industries to expand their phosphate capabilities. Economists typically use the figure that, for each person directly employed in mining and manufacturing, there are three indirect support type employees. Thus, one can calculate a total employment loss of over 18,000 between 1980 and 1984 at a time when world total phosphate markets were growing, and with increasing shares being taken by competitors in North Africa and the Near East.

At an estimated annual salary of $25,000 per employee, one can calculate an employment income loss of $450 million in 1984 alone.

Thus, with this figure of $450 million in employment income lost in 1984, and with $200 million lost in foreign exchange earnings from lost exports, one arrives at a total figure of $650 million lost in 1984 by the U.S. as a result of declining market shares for U.S. phosphate producers and the resultant drop in employment.

All this loss cannot be attributed to expansions in North Africa as a result of Eximbank support. However, a significant part of this loss can be directly attributed to Eximbank assistance in expanding phosphate production of state trading enterprises in North Africa. We think Eximbank would not have spent more than $200 million in the last several years in that region had it followed the congressional guidelines for its operations, namely that it will not provide assistance to an industry that is structurally over-built, and that it will not provide assistance to a foreign industry whose subsequent increased exports will result in economic injury to the U.S. economy.

SUMMARY

Clearly, the $200 million assistance from the U.S. Eximbank to state-owned North African phosphate producers in recent years has resulted in increased world capacity and increased exports of phosphates from those producers in direct competition withh U.S. producers. With this record, the Senate Finance Committee should evaluate further U.S. assistance to enterprises engaged in state trading.

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